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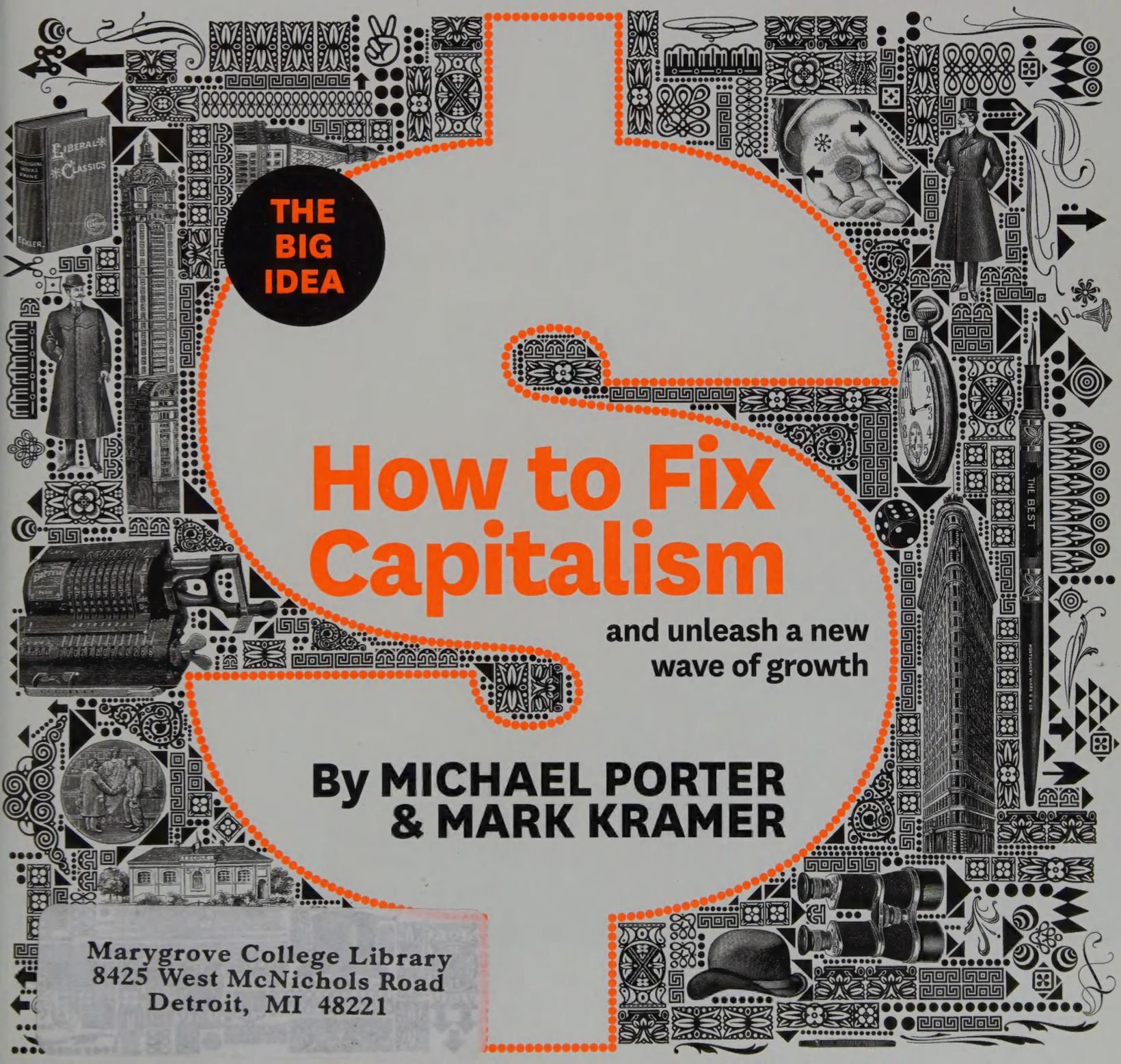
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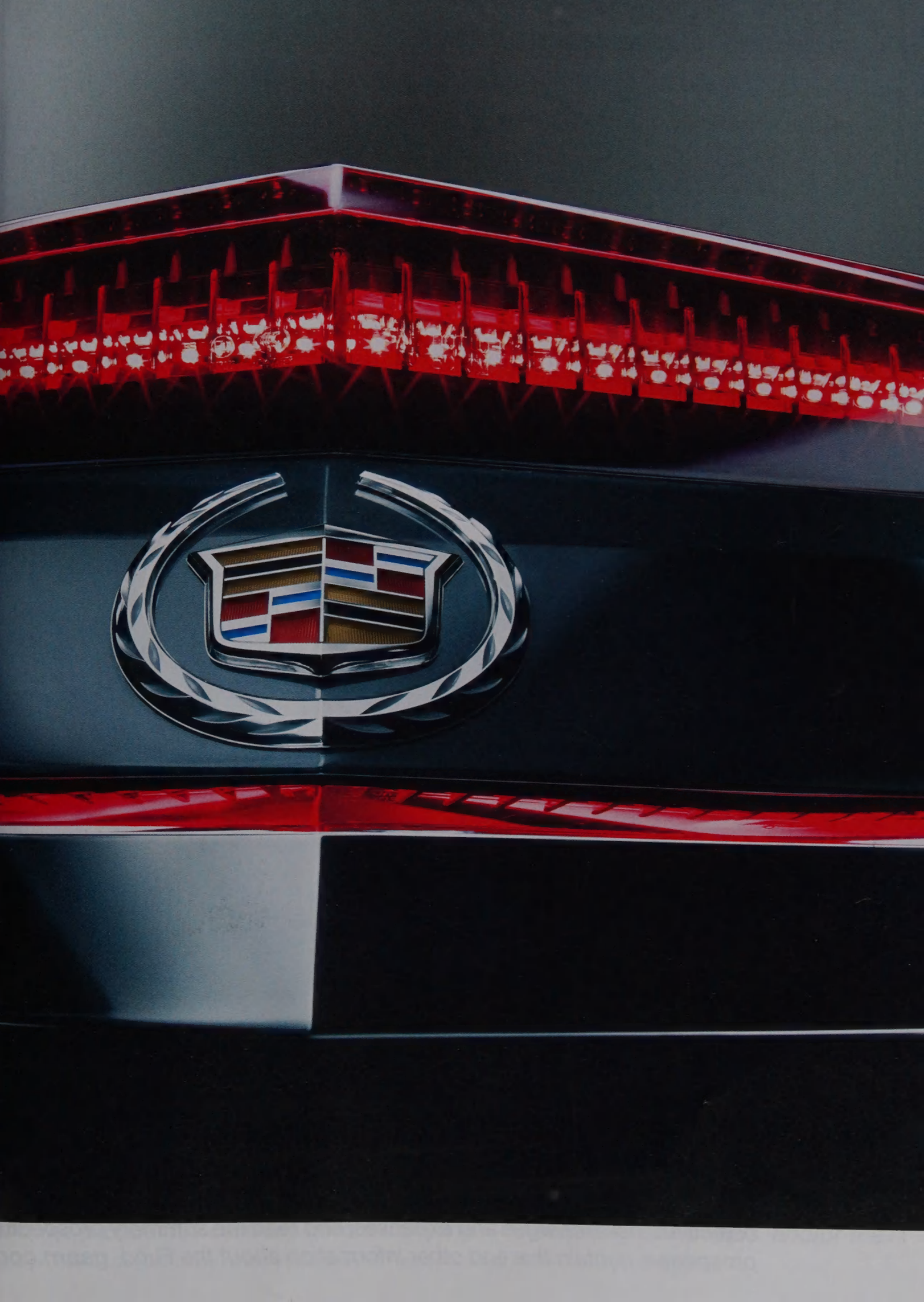
and unleash a new wave of growth

By MICHAEL PORTER & MARK KRAMER

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-John and Erin O'Sullivan, Benchmark Clothing founders





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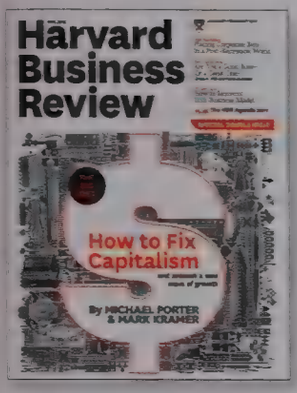
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Cover Artist
Lorenzo Petrantoni



About the Spotlight Artist
Damián Ortega was born in 1967 in Mexico City. He studied in Gabriel Orozco's informal studio class in the late 1980s. There he absorbed the acute attention to form associated with Orozco's sculpture and photography, and subsequently refined his own visual and conceptual vocabulary.

In his work, Ortega never allows objects to rest—they are pulled apart, suspended, or rearranged, calling attention to the dynamism of the world around us. He brings a subtle, incisive wit to familiar materials. Bricks, old tools, Coca-Cola bottles, tortillas, and even a Volkswagen Beetle are assembled and reassembled in playful and imaginative ways.

Ortega currently lives and works in Berlin and Mexico City.



PHOTOGRAPHY: STEPHEN WHITE, COURTESY WHITE CUBE

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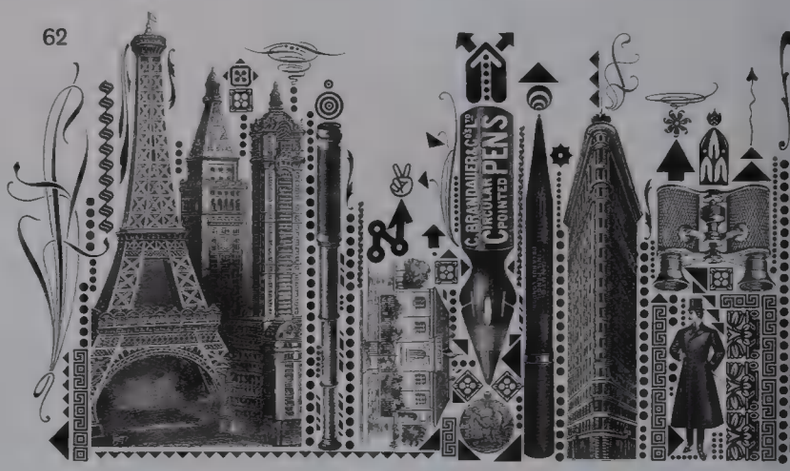
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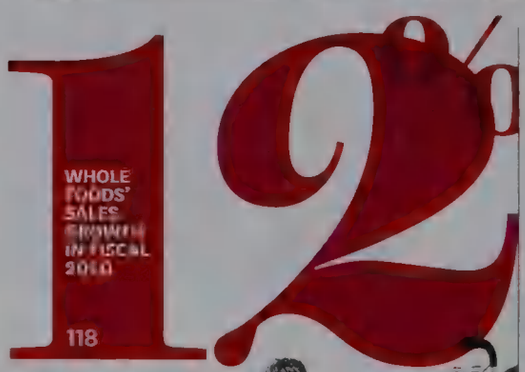
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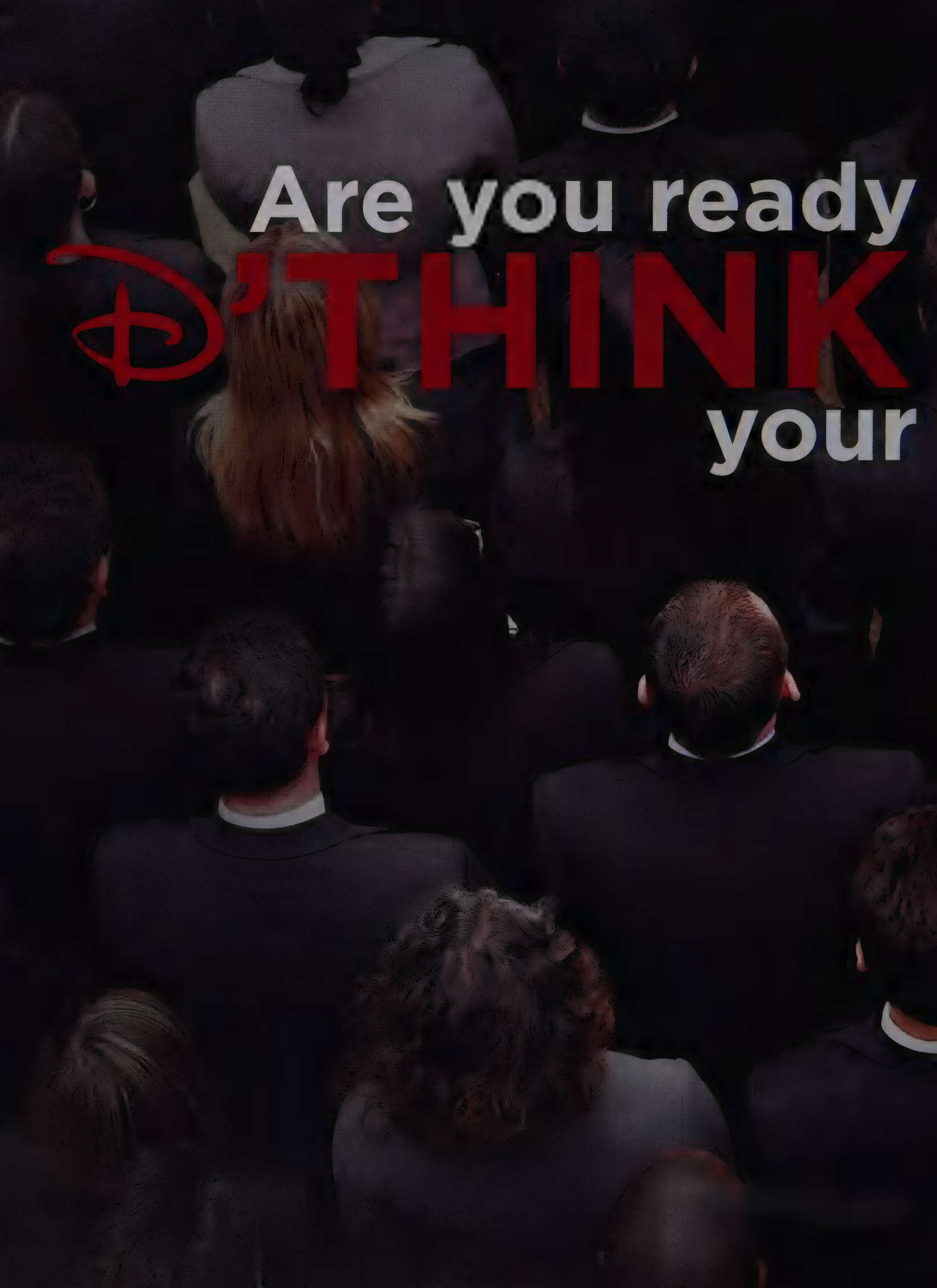
What a predictive model means to a hospital in Africa.

It means that this hospital in Ethiopia will be able to help HIV patients receive the best treatment regimen possible. The EuResist Network is helping doctors predict patient response to multiple HIV treatments with over 78% accuracy. In a recent study, the EuResist prediction engine outperformed 9 out of 10 human experts in choosing the best drug combinations for a range of HIV genetic variants. The tool is built on an IBM analytics solution that integrates over 41,000 HIV treatment histories from a variety of disparate databases onto a flexible IBM DB2® platform. A smarter organization is built on smarter software, systems and services.

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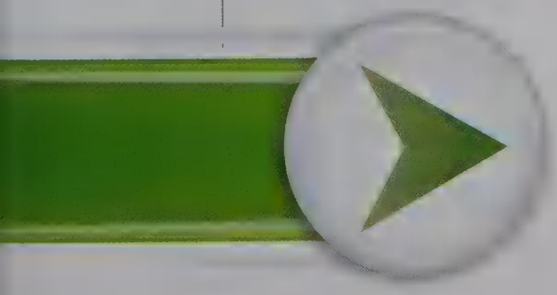
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Ron Ashkenas is a managing partner of Schaffer Consulting and the author of *Simply Effective* (Harvard Business Review Press, 2009). Read why he thinks that best practices are hard to practice at blogs.hbr.org/ashkenas.



Justin Fox is the editorial director of HBR Group and the author of *The Myth of the Rational Market* (HarperCollins, 2009). Find out why he thinks the economy is getting messier at blogs.hbr.org/fox.

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From the Editor

This month's spotlight artist, Damián Ortega, subjects everyday objects to what he calls a "mischievous transformation."



ABOVE
Módulo de construcción con tortillas
1998, corn tortillas

How Businesses Behave

With this month's cover story, we present important new thinking from Michael Porter. The Harvard Business School professor has been one of HBR's most admired and cited authors, dating back to his first article for us, "How Competitive Forces Shape Strategy" (1979) which popularized his "five forces" business-strategy framework.

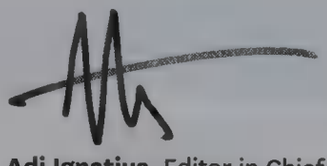
This month, Porter and his colleague Mark Kramer, a social-impact consultant, take on a very different subject: rethinking the nature of the corporation. They argue that the globe's new challenges require companies to pursue "shared value"—that is, organizations must innovate and create economic value in a way that also addresses society's needs.

It's an idea that advances some of the most interesting thinking in recent years about business and its role in society. HBR has proudly been home to many of these important ideas.

In "The Age of Customer Capitalism" (January–February 2010), Roger Martin, dean of the Rotman School of Management, argues that shareholder-value capitalism has failed to produce long-term health for companies and to deliver top value to shareholders; what's needed now, he says, is a focus on creating value for customers. In "Leadership in the Age of Transparency" (April 2010), Monitor Talent's Chris Meyer and HBR's Julia Kirby demonstrate that heightened social awareness and our improved capacity to measure companies' impacts on society require firms to track and mitigate damage from "externalities"—all as part of normal business operations. And Umair Haque, the Havas Media Lab director and one of HBR's most popular bloggers, makes a case in *The New Capitalist Manifesto* (HBR Press, 2011) for a complete rethink of a global business model that hasn't much changed since the industrial age.

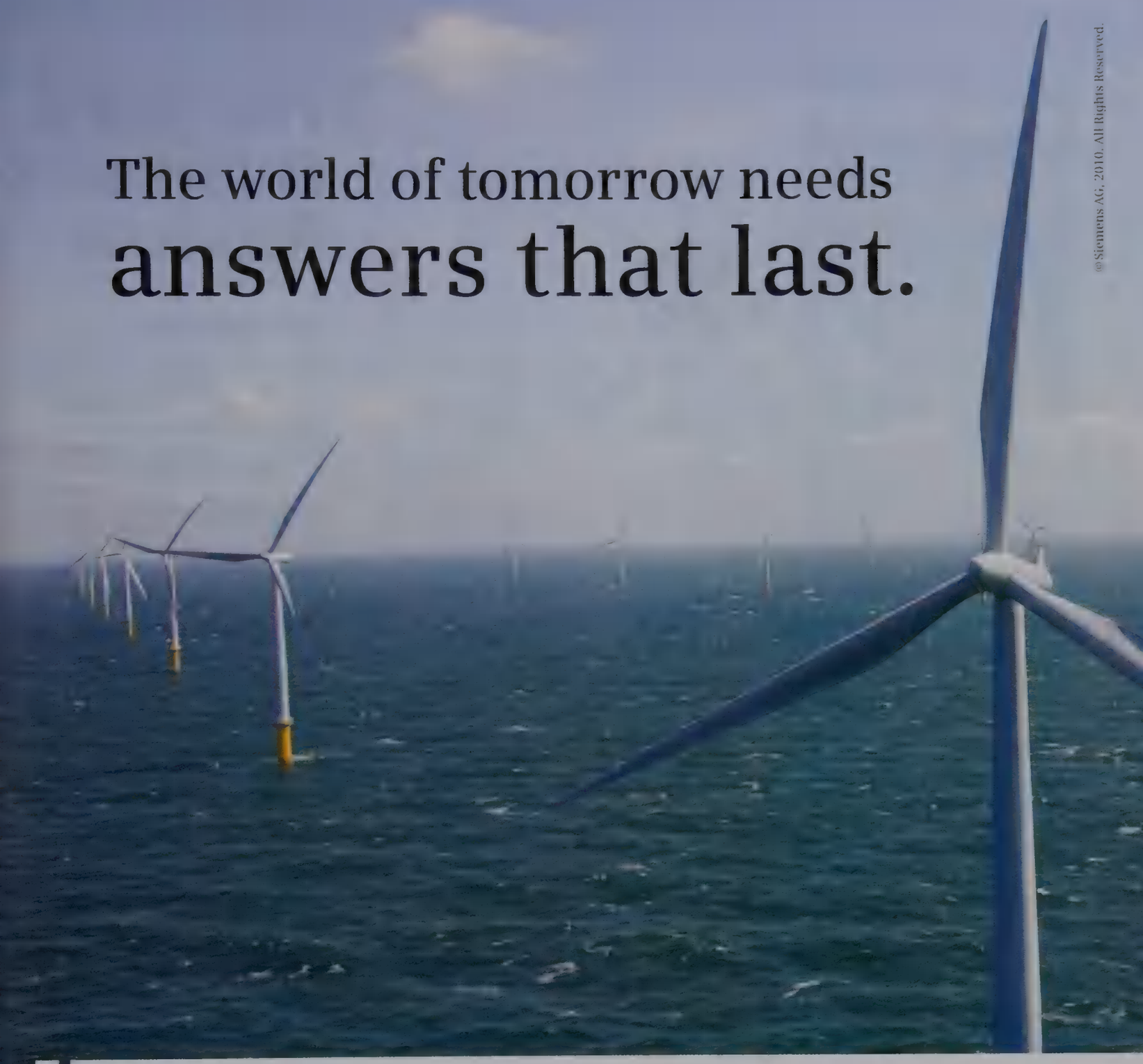
Now Porter and Kramer enter the fray, applying a hard-nosed business and strategy framework to the question of companies' role in society. Through shared value, they say, corporations use "their skills, resources, and management capability to lead social progress in ways that even the best-intentioned governmental and social sector organizations can rarely match." It starts with companies redefining their purpose around creating products and services that generate social benefit. "In the process, business can earn the respect of society again."

Realigning the role of business in society defies simple solution, and we welcome your thoughts. Visit us online at hbr.org and comment on this piece. If enough good minds apply themselves, a new and better way forward just might take shape.



Adi Ignatius, Editor in Chief

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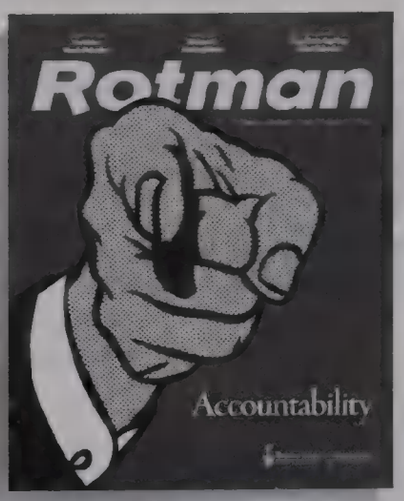
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Frontline Leadership



HBR blog series, October–November 2010

"Even generals have to learn to excel under pressure," Paul Sullivan says in "How Cadets Learn to Be 'Clutch,'" a blog post in our "Leadership Lessons from the Military" spotlight. HBR bloggers covered topics ranging from strategy execution and training to coordinating teams and carrying out the commander's intent. Some readers found that military best practices might be too different from those in business to follow, while others saw deep parallels and apt lessons.

"Military Skill Sets Lead to Organizational Success," by Chad Storlie *The military offers "[w]orld-class, combat-honed, and expansive skill sets in strategic planning, war-gaming (competitor-on-competitor role play), competitive intelligence, leader development, rigorous standard enforcement, and innovation in execution."*

The military-to-organization model is problematic because of the armed forces' rigid chain of command and its use of disciplinary sanctions for noncompliance.

Posted by **Toni Hynds,** President and Lead Consultant, Hynds Consulting Group

Storlie responds: *As the mission's available resources and competitive landscape change, military personnel can quickly adapt while achieving the commander's intent—acting more, not less, independently.*

"The Strategic Corporal," by Rye Barcott *As "the lowest ranking noncommissioned officer in the Marine Corps," strategic corporals often must lead their teams through peril without help from superiors. "Corporals have to make quick decisions, some of which can carry strategic implications."*

Although pushing decision making down to "the lowest ranking noncommissioned officer" might seem like a good idea, it can result in the deterioration of the chain of command and to very bad decisions with awful results. For example, during the torture of prisoners in Abu Ghraib, where were the officers? Where was military discipline?

Posted by **Marc Brenman,** Principal, Social Justice Consultancy

The commander's intent must be understood by every leader, creating autonomy even in small units. The Abu Ghraib debacle was an anomaly and no more or less despicable than the executive abuse of privilege at Enron or Lehman Brothers.

Posted by **David Tillman,** Director of Consulting, CGI Federal, and Retired U.S. Marine Gunnery Sergeant

Barcott responds: *The idea that decentralized decision making contributed to the tragic abuses that occurred at Abu Ghraib is wrong. I spent some time at Abu Ghraib in 2006 and remain troubled by the horror that occurred there and by the fact that our military leadership was never held fully accountable. The abuse did not happen because of a few corporals gone astray but because of severely flawed leadership at the highest levels of our government, that, through policy and culture, created the conditions that made the unthinkable possible.*

The Sustainable Supply Chain

HBR interview with **Peter Senge,** October 2010

When asked what it takes for a company to get serious about issues like water, energy, and waste in its supply chain, Senge answers, "I use the word 'sustainability' as little as possible because it's so generic; it makes people's eyes glaze over."

Senge raises necessary points, but he provides little traction on how we can begin to move forward. Why does this implementation void exist? Sustainability prompts far less enthusiasm than was once anticipated. The Global Reporting Initiative tells us that a very small percentage of companies have truly invested in sustainability. Books and magazine articles tend to describe the "what" of sustainability and avoid the "why" and the "how."

At meetings where sustainability initiatives are discussed, there is no absence of head-nodding in response to the CEO's mandates. After all, sustainability will be part of the next performance appraisal. But that does nothing to drive true buy-in. Naysayers should be encouraged to speak up in these meetings—and the organization should pay attention to their concerns.

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"Good Communication, Better Orders," by Bill Dunham *"A tactical commander facing a snap decision might have time to ask only the odd cursory question. But...he will have talked to his men and colleagues... and the discussions all go into the collective memory bank so that next time around, the decision is slicker and the team works better."*

It is rare for managers across teams to meet together to discuss and learn what has worked for them (or not).
Posted by **notmd**

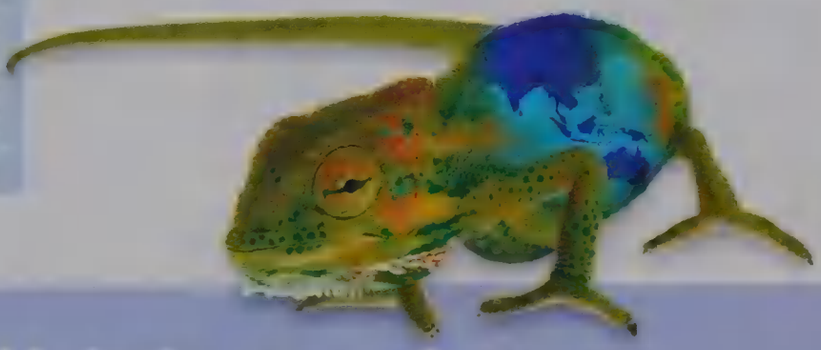
"Four Steps to Improved Frontline Execution," by Ed Barrows *"A specific type of combat order, known as the five paragraph order, is so fundamental to the Corps's success that every Marine must learn and use it in the planning and execution of every mission." It addresses the high-level situation and the details of the mission's execution.*

The officers I know treat each decision as though it had life or death consequences. These steps build effective communication, which builds trust, ensuring alignment of the mission.
Posted by **Louis Bonhomme,** Project Manager and Technical Lead, EMD Millipore

Employees see sustainability as a fad; investors want their return but know that green R&D spending will have a short-term, negative impact. On this issue, compliance spells doom. Expect that.
Gary R. Carini, Professor and Associate Dean for Graduate Programs, Hankamer School of Business, Baylor University
Mark Dunn, Professor of Marketing, Hankamer School of Business, Baylor University

It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.

—CHARLES DARWIN



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Mar 27–Apr 1	Driving Strategic Innovation: Achieving High Performance Throughout the Value Chain (*in partnership with IMD*)
Mar 29–30	Transforming Your Business Through IT
Mar 29–30	Understanding Global Markets: Macroeconomics for Executives
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Mar 31–Apr 1	Managing Complex Product Development Projects

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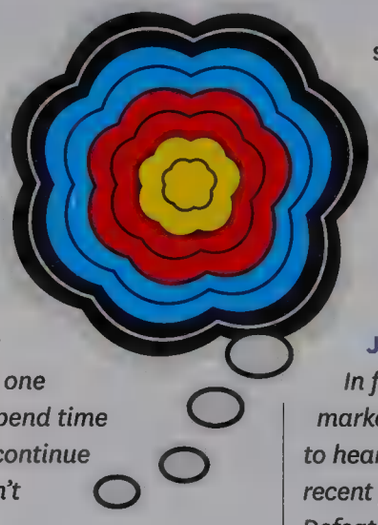
Interaction

Developing Your Disruptive Skills

HBR blog series by **Whitney Johnson,** September–October 2010

"We often overlook our best skills...simply because we perform them without even thinking," suggests Whitney Johnson, Rose Park Advisors' founding partner. The key to developing these skills is first to identify them through honest introspection. But not all unique skills are innate. "Hard won," "pay to play" skills are critical, too, she says, "not because they change your game significantly, but because they allow you to play your disruptive game increasingly well."

The frustration of genius is in believing that if it is easy for you, it must be easy for everyone else.
Posted by **Alana Cates,** Owner and Operator, Accelerated Profit Solutions



Johnson responds: *You could ask yourself, What do I do reflexively well? Or, What do I think about when I don't have to think about anything? Or, What one or two things do I spend time doing that I would continue to do even if I weren't compensated?*

Johnson makes a distinction between intuitive skills and "pay to play" skills, which often come the hard way. But maybe that's why they're so valuable. The very fact that no one is simply born with them means that they show one's ability to work hard, stick to a task, or make opportunities for oneself. That's why that Stanford Law degree (and other such status signals) are so valued by the market—not just as evidence of material learned, but as proof of one's character, showing the qualities that allowed one to make it that far.
Posted by **Blake Clayton,** Doctoral Student, University of Oxford

Johnson responds: *Precisely, Blake. In fact, one of the reasons the emerging markets are so interesting at this point—to hearken back to Michael Schrage's recent post, "How BRIC Innovators Will Defeat You"—is that there are many individuals within these markets who know how to work really hard and who have been fortunate enough to also get a good education, honing their innate skills.*

Having recently started my first job, I've spent quite some time trying to discover how to best apply my interests and strengths in the job market. I've found that developing a winning combination of skills instead of finding the holy grail of individual genius sets me apart from my peers.
Posted by **Megan Nelson,** Financial Analyst, Intel Corporation

Johnson responds: *Pairing journeyman skills with what we do "magically" is how we begin to maximize our value in the marketplace.*

Challenges that left me exhausted often left me happiest. They weren't necessarily the most lucrative, but they honed my skills for tougher things to come.
Posted by **Erik Orton,** Founder, Principal, and Chief Creative Officer, O Productions

Johnson responds: *I had no life other than work for several years. And it was exhilarating. There is something about paying your dues, heading home at two in the morning, and realizing, I am exhausted, but I am doing this. I can get this done.*

Make Meetings Work: Fight the PowerPoint

HBR blog post by **Justin Fox** and **Robert C. Pozen,** October 2010

In this installment of HBR's interview series on personal productivity, Harvard Business School's Bob Pozen advises meeting organizers on "how to structure meetings that don't waste anybody's time."

Any tweaks with regard to conference calls?
Posted by **A.C. Ganger,** CEO, One.MD

Pozen responds: *Structure the discussion. The meeting should begin with a roll call so that everyone knows who is participating and their affiliation. Then the leader of the call should pose the questions to be decided on and summarize the key points. It would be great if participants received a background document before the call, but that is often not feasible.*

After this initial stage, the leader should ask for comments in as structured a way as possible. For example, if there are three issues to be decided, the leader should start with the one that is logically first and ask for comments on that issue. After comments become repetitive or die out, the leader should summarize where the group seems to be on the first issue and ask for feedback on that statement. Once there is a consensus on where the group stands on the first issue, the leader should move on to the next issue.

Before the conference call ends, I would try to solicit the opinion of anyone who has not yet spoken. I have learned that silence is not necessarily agreement. Then try to summarize the conclusions of the group and ask for feedback on the accuracy of that summary. Finally, ask what next steps the group believes it should take and within what time frames.

ILLUSTRATION: MATT DORFMAN



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Idea Watch

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FIRST

Ditch the Discounts

Smart companies used adaptive pricing to ride out the recession. Now it's time to reprice for recovery.

by Rafi Mohammed



ILLUSTRATION: ANDY MARTIN

The first shot in what historians may someday commemorate as the Great Pizza War was fired by Domino's in late 2009. The chain had been charging about $9 for a medium two-topping pizza, but to boost sales it began offering recession-weary consumers two of its two-topping pies for $5.99 each. Several weeks later Papa John's and Pizza Hut fired back, offering large three-topping pizzas for just $10—at least a third less than the usual price. Soon they improved the deal, so that customers could buy a large pizza with unlimited toppings for $10. Sure enough, sales at all three chains rose—and even now many chains are offering discounted pizzas.

On the surface, this type of price-cutting makes sense: How else to bolster sales in a time of weak demand? But even though the recession has been officially over for 18 months, its effects are likely to linger; GDP has been growing at a sluggish pace. In this environment, few companies have much pricing power—and in many industries, discounts will remain the norm.

That's unfortunate, because across-the-board price cuts unnecessarily reduce profits. Consider a company that held the line on prices during the recession and saw a 20% drop in sales. That means it made 80% of its usual sales, even at full price—so why give discounts to all those customers? More important, deep discounts devalue a product or service, limiting companies' ability to raise prices as the economy improves. If people get used to paying $10 for a large pizza with lots of toppings, it's hard to restore a price of, say, $16.99 when demand picks back up.

Some companies have avoided this trap by using adaptive pricing, which capitalizes on the fact that different customers have different needs and therefore place different values on a given product or service. As we wait for the economy to return to full speed, managers have a good opportunity to learn from companies that weathered the recession by employing adaptive-pricing strategies—and to develop plans that could help their own businesses regain lost ground in the recovery.

The key to adaptive pricing is realizing that price, like color or style, is simply one of a product's attributes. And companies routinely vary colors and styles to appeal to different kinds of customers. They sell through different channels (online, direct sales, brick-and-mortar stores) and sometimes charge vastly different prices based on the channel. (A box of cereal typically costs much more in a convenience store than it does in a big-box store.) By using adaptive pricing, companies can adjust a product's attributes to better appeal to customers' sense of value without necessarily dropping the price.

HOW TO PRICE...

Introduce Lower-Priced Versions

To defend the price of existing offerings while attracting budget shoppers, create bargain versions. For its 2011 lineup, Harley-Davidson is introducing the SuperLow. The aim: to allow "even the most budget conscious rider to own a Harley-Davidson."

Use Promotions to Avoid Price Drops

Instead of reducing nightly rates, Disney resorts offered promotions such as "Buy 4 Nights, Get 3 Free." This type of deal lowers the effective cost without changing the advertised nightly rate—a form of discounting that avoids devaluing the brand in consumers' minds.

Adapt Products to Maintain Affordability

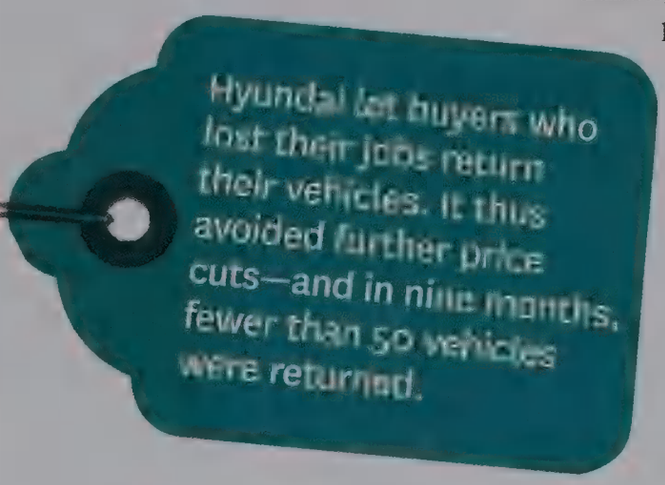
Companies in many categories, including peanut butter, juice, cereal, and soap, faced higher costs and so decreased product size or volume. This strategy increases the price per unit but maintains the overall sticker price—the one consumers are more apt to notice.

Unbundle Services And Add Extra Fees

As travel demand dropped, airlines added fees for telephone reservations, luggage, meals, and preferred seats. This allowed them to advertise low prices and attract price-sensitive customers while earning higher profits from travelers willing to pay a premium.

IN A RECESSION

The simplest adaptive-pricing method is called "versioning"—offering "good," "better," and "best" varieties of the same product. A lower-priced version (poorer quality, smaller quantity, fewer features) can be a powerful magnet for price-sensitive customers. The method worked well for consumer product companies during the recession and should be considered by all companies, especially those in markets with weak demand. P&G has had great success with it. In 2005 the company created "Basic" lines of Charmin toilet tissue and Bounty paper towels, aimed at low- and middle-income consumers who wanted quality but didn't want to pay premium prices. The Basic products utilized one-ply sheets and cost 15% to 25% less than the regular ones. A.G. Lafley, P&G's former CEO, noted that brands that had used versioning outperformed the company's other products during the recession. (The strategy has its downsides, though; see "Should You Launch a Fighter Brand?" HBR October 2009.)



Let's look at two very different approaches to recession pricing in the fast food industry. Subway won acclaim and saw sales jump by 17% in 2008, when it dropped the price of its foot-long sandwiches to $5—thus taking a traditional tack. But customers have become conditioned to paying that amount, and the chain is continuing to offer some foot-long sandwiches at that low-margin price. In contrast, Quiznos created entirely new inexpensive sandwiches: $2 Sammies, $3 Bullets, and $4 Torpedoes. This adaptive-pricing technique allowed it to continue charging full price for its signature items and avoid Subway's dilemma when the economy started to improve.

Some of the most successful adaptive-pricing innovations may not even seem, on the surface, like pricing innovations. One of the boldest was Hyundai's Assurance program, which the company introduced in January 2009. Despite steep price cuts, automobile sales had dropped sharply the previous fall as customers reacted to the continuing economic crisis. "What we heard consistently was, 'I know the deals are good, but I'm worried that if I lose my job, then I'll lose the car,'" Hyundai's top U.S. executive, John Krafcik, has said. So the company came up with a way of assuaging this fear. The Assurance program let buyers who lost their jobs stop making payments and return their vehicles. By providing this safety net, Hyundai was able to prosper without making further price cuts. While the U.S. market for auto sales dropped by more than 20% in 2009, Hyundai's U.S. sales increased by 8%. And the cost to the company was minimal: During the first nine months of the Assurance program, fewer than 50 cars were returned.

Sometimes creative financing is the best way to hold the line on prices. This is far from a new technique; carmakers and consumer appliance companies have used credit policies to boost sales since the 1920s, and General Motors came out with a highly touted 0% financing offer after the September 11 attacks. But some marketers deployed especially creative financing strategies during the latest recession. For instance, in 2008 Best Buy offered two-year, no-interest financing for purchases totaling at least $999—far more than the average person spends at one time in a consumer electronics store. "Some customers [were] literally adding items to their shopping cart so they would hit the $999 minimum," Best Buy executive vice president Mike Vitelli later said. The same year Best Buy's main rival, Circuit City, filed for bankruptcy and shut down.

Adaptive pricing is such an effective tool, in fact, that sometimes it works *too* well. In 2009 Tony Maws, the owner of a high-end restaurant in Cambridge, Massachusetts, called Craigie on Main, wanted to boost evening business during the week without cutting into profits on the weekend, when the restaurant was typically full. So he instituted a midweek special—a drink and two appetizers for $29.99—available to customers seated at the bar from 5:30 to 6:00. Soon

Withdraw Recession-Pricing Tactics

Tide Basic, launched in 2009, cost 20% less than regular Tide. P&G withdrew it in 2010 as regular Tide began regaining market share in the U.S. Similarly, restaurants like Ruby Tuesday have begun cutting back on price promotions and are maintaining growth.

Introduce New Premium Products

As the economy picks up, take advantage of consumers' willingness to splurge. Panera recently sold a lobster roll for $16.99. Concert promoters are offering VIP packages with more features; for example, last year one Bon Jovi package sold for $1,875.

Increase the Price of Regular Products

When you raise prices, it's important to tell customers why. Some common reasons: "Our costs are rising" and "During the recession, we lowered margins to help customers." Last fall Kraft, General Mills, and McDonald's all announced price increases.

Offer New Ways to Experience Luxury

JetSuite customers can now take a four-person private plane from Van Nuys, California, to Las Vegas for $999. Ritz-Carlton has a "Resort Reconnect" promotion targeted at couples who are feeing flush enough to resume vacationing at upscale resorts.

the bar was not just full but overflowing with standing-room-only customers who also wanted, and were given, the special deal. After a month Maws decided to end the promotion—it had created too much demand.

One of the biggest advantages of adaptive pricing is increased flexibility as the economy begins to rebound. For instance, P&G simply withdrew Tide Basic from the market in June 2010; it didn't have to wean customers off any recessionary discount on the regular brand. Other companies are courting newly flush consumers by introducing higher-quality, higher-priced versions of some items. In the summer of 2010 Burger King began selling premium fire-grilled ribs for $7.19 an order. Customers quickly bought up the entire supply—10 million ribs.

Although the anemic recovery may have you wondering whether consumer demand will ever return in full force, rest assured that it will—and when it does, you need to be ready. For companies that view pricing as just an "increase or decrease" strategy, readiness is primarily a matter of deciding when it's time to flip the switch. But such companies will be missing an opportunity. If you implement a creative, constantly evolving array of pricing strategies, you can more effectively reach new customers—and transfer more of their money to your bottom line. **HBR Reprint** F1101A

Rafi Mohammed (rafi@cultureofprofit.com) is the founder of the consulting company Culture of Profit and the author of *The 1% Windfall: How Successful Companies Use Price to Profit and Grow* (Harper Business, 2010).

A BETTER WAY TO MAKE DEALS ON MEALS



When it comes to adaptive pricing, it's tough to beat the airline and hotel industries, which have used "yield management" systems for many years. But another industry is becoming smarter about pricing: restaurants.

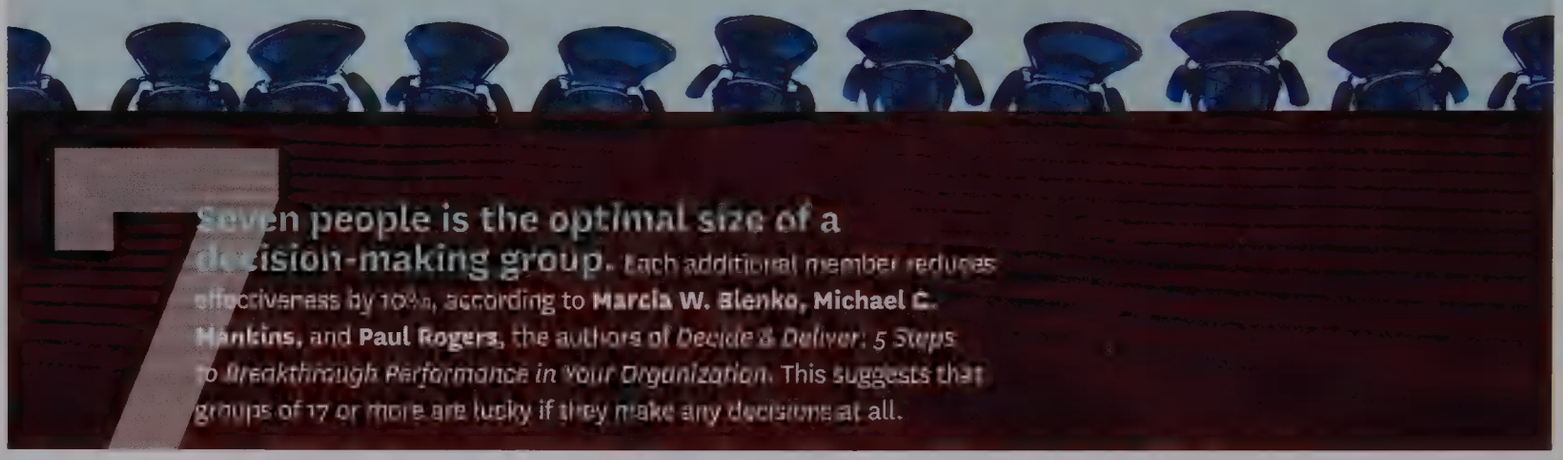
As the economy recovers, some high-end restaurants are trying more-innovative pricing models. Star chef Grant Achatz plans to open a restaurant called Next in Chicago. It will sell tickets online for meals at specific dates and times, basing the price on the popularity of the slot reserved. A five-course meal might cost $75 at 8 on Saturday; the identical meal might cost only $45 at 6 on Tuesday.

This strategy has risks. Customers might simply go elsewhere on Saturdays. They might devalue Next's food, thinking, "I can get the same meal for half the price on Tuesday."

Here's a better idea: Keep the prices of entrées the same, but set minimum customer spending levels, varying them according to demand. A high-end restaurant might require a diner to spend $150 on a Saturday night but only $75 on a weeknight. This arrangement would allow free-spending customers to choose the popular night (and spend more on high-margin items like cocktails and desserts), while letting frugal diners ("Just an entrée and tap water, please") find a seat on a slower night. It avoids charging different prices for the same food and also has the advantage of flexibility: If a given Saturday is slow to book, the restaurant could lower the minimum in its reservation system. And the strategy could work for restaurants at all pricing levels, not just upscale places serving five-course meals.

Stat Watch

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7 **Seven people is the optimal size of a decision-making group.** Each additional member reduces effectiveness by 10%, according to **Marcia W. Blenko, Michael C. Mankins,** and **Paul Rogers,** the authors of *Decide & Deliver: 5 Steps to Breakthrough Performance in Your Organization.* This suggests that groups of 17 or more are lucky if they make any decisions at all.

LEADERSHIP *by Susanne Bruckmüller and Nyla R. Branscombe*

How Women End Up On the "Glass Cliff"

By now everyone is familiar with the glass ceiling—the informal barrier that keeps women out of upper management. In the past few years, researchers have found that women have a better chance of breaking through that ceiling when an organization is facing a crisis—thus finding themselves on what Michelle Ryan and Alex Haslam, of the University of Exeter, have termed the "glass cliff." But the question remains why.

To explore possible answers, we conducted two experiments. In the first we asked 119 college students to read two newspaper articles about an organic food company. The first article discussed the upcoming retirement of the CEO. We created two versions of the piece; in one the company was currently and historically headed by men, and in the other it was headed by women. We also created two versions of the second article, which dealt with the company's financial status, so that some students read about a company that was growing, others about one that was closing stores and laying people off. We then asked the students to choose between two equally qualified candidates for CEO, one male and one female.

When the company had been led by men and was doing well, 62% of the students who read that scenario chose the male candidate. But when the male-led company was in crisis, 69% chose the female candidate. And when the company had been led by women, there was no difference: The glass cliff disappeared.

One thing these results reveal, we believe, is a status quo bias. As long as a company headed by men performs well, there's no perceived need to change its pattern of male leadership. Only if male leaders have maneuvered an organization into trouble is a switch to a female leader preferred.

Our second experiment was designed to test our hypothesis that attitudes about gender and leadership also help create the glass cliff. We asked 122 students to read an article about a supermarket chain that was either very successful or struggling badly. In both cases the CEO was about to be replaced. The students read descriptions of a male and a female candidate and rated each one's strength in 10 areas, some having to do with stereotypically female attributes (such as communication skills and the ability to encourage others), others with stereotypically male ones (such as competitiveness and decisiveness). We then asked which candidate they would choose as CEO. We found that when a company is doing well, people prefer leaders with stereotypically male strengths, but when a company is in crisis, they think stereotypically female skills are needed to turn things around. Accordingly, most participants (67%) chose the man to head the successful company, while the majority (63%) thought the woman should take over the company in crisis.

It appears, then, that a company's leadership history and common assumptions about gender and leadership contribute to the glass cliff. We were especially struck by the finding that the phenomenon does not seem to apply to organizations with a history of female leaders. This suggests that as people become more used to seeing women at the highest levels of management, female leaders won't be selected primarily for risky turnarounds—and will get more chances to run organizations that have good odds of continued success.

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ONTO A LEDGE: CEOs who've lived out this trend



CARLY FIORINA
HEWLETT-PACKARD
1999–2005



PATRICIA RUSSO
LUCENT AND ALCATEL-LUCENT
2002–2008



KATE SWANN
WHSMITH
2003–



LYNN ELSENHANS
SUNOCO
2008–

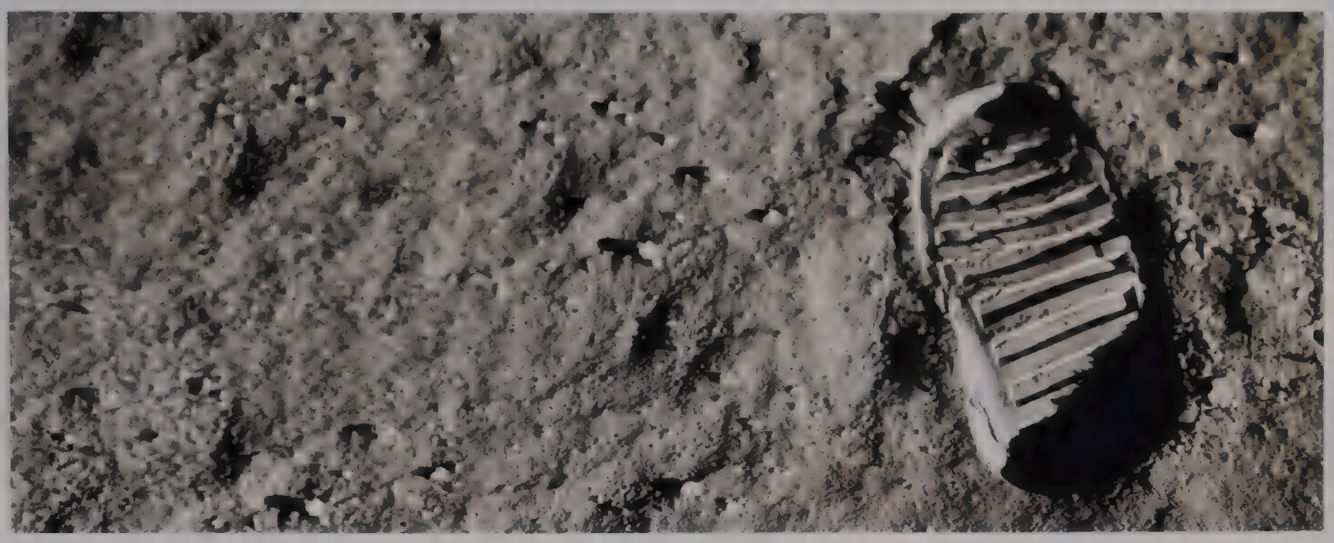


CAROL BARTZ
YAHOO
2009–



Susanne Bruckmüller is a research associate at the University of Erlangen-Nuremberg. **Nyla R. Branscombe** is a professor of psychology at the University of Kansas.

Until Neil Armstrong walked on the Moon, he would not rest. Nor would his crew. (Sea of Tranquility, 1969.)



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fixed income, structured products and currencies.

Although that, too, is nice to know.

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Research Watch

RESEARCH

How Online Retailers Can Avoid TMI



As anyone who's sold an item on eBay knows, high-quality images can help persuade online shoppers to make a purchase. When giving buyers a receipt, though, a low-quality drawing can be a better choice. **Jacqueline Conard**, an assistant professor of marketing at Belmont University's College of Business Administration, in Nashville, observed that the high-quality photos some online retailers included on their receipts rarely looked good after a trip through a home printer—and rarely brought the retailers any benefit. She found that simple line drawings were more apt to increase customers' satisfaction, inspire word-of-mouth recommendations, and lead to repurchases. "The idea here is to provide enough information to allow [buyers] to feel good about the money that they had just spent—but not enough detail to allow their memory of their purchase to be altered," she says.

MORALE *by Utpal M. Dholakia*

Why Employees Can Wreck Promotional Offers

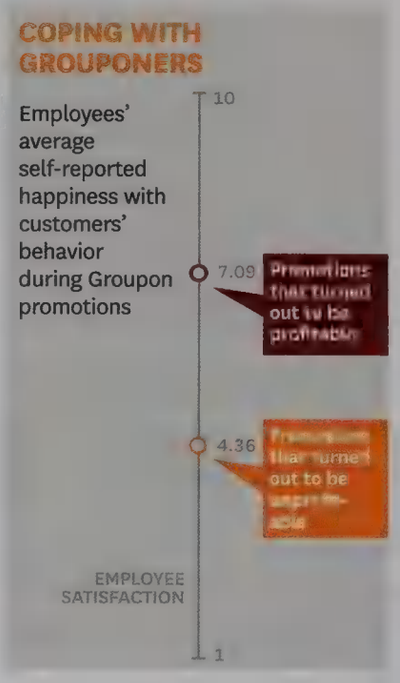
In theory, the social media site Groupon is a win-win for consumers and businesses. Shoppers get deep discounts at stores and events, and companies get a massive influx of customers. But there's a crucial weak link in the chain, a vulnerability faced by any service company that's offering a promotion: Employees.

If employees at a company using Groupon aren't happy with the promotion, my research shows, customers may have a bad experience, and the company may obtain no long-term benefit. And many employees *aren't* happy when Groupon comes on the scene: They're the ones serving the meals and waxing the eyebrows of customers who are sometimes less than gracious.

"Most of the Grouponers are deal seekers," one restaurant owner said during a survey I conducted of 150 businesses that used Groupon from June 2009 to August 2010. "They felt entitled to special treatment, didn't spend more than the price of the Groupon item itself, and didn't tip."

Groupon is the best-known of several new sites that marry social media and coupon marketing. (Others include LivingSocial, BuyWithMe, and Scoutmob.) It offers a daily deal—$50 worth of clothing from The Gap for $25, for instance, or a $175 facial for $59. The coupons are valid only if a certain number of people buy them, so would-be users must rally their friends, typically via Facebook or Twitter. Some deals attract more than 20,000 buyers.

Many coupons are for things you don't usually see discounted—artisanal bread, kayak rentals, helicopter-flying lessons—and many of the participating businesses have little experience with coupons and bargain hunters. As a result, managers may fail to anticipate how an onslaught of customers will affect their employees. Workers often resent the extra work they have to do and don't grasp the logic behind the special deal. "Some employees thought we shouldn't be giving away the product for so little," one business owner told me.



Overworked or skeptical employees are less able (or inclined) to create a positive customer experience. Their behavior can make the Groupon offer backfire, since two keys to reaping profits from the coupons are getting the Grouponers to buy items in addition to the discounted one and to become repeat customers who will pay full price in the future. In fact, preparing employees for upcoming promotions and obtaining their buy-in is the most important factor influencing a Groupon promotion's success: Employees at businesses where the coupons generated profits had a 63% higher satisfaction rate, in terms of how they viewed customers, than employees at businesses where the promotions failed. This association is compelling evidence that managers deciding to try Groupon should take steps to keep their employees content—for example, by agreeing ahead of time to compensate them for longer hours or lower tips.

Another important variable affecting the success of Groupon discounts, of course, is how many of the coupon users are new customers; giving existing customers a lower price will hurt, not help, long-term profits. But it's hard to overstate the value of getting employees into the right frame of mind for Groupons—or any promotion, for that matter. Your employees stand between your product and your customers, and ultimately they're the ones who will make a promotion succeed or fail.

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Utpal M. Dholakia is an associate professor of marketing at Rice University's Jones Graduate School of Business.

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Defend Your Research

HBR puts some surprising findings to the test



Francis J. Flynn is the Hank McKinnell–Pfizer Inc. director of the Center for Leadership Development and Research at Stanford's Graduate School of Business.

Guilt-Ridden People Make Great Leaders

The finding: People who are prone to guilt tend to work harder and perform better than people who are not guilt-prone, and are perceived to be more capable leaders.

The research: Francis Flynn gave a standard psychological test, which measured the tendency to feel guilt, to about 150 workers in the finance department of a *Fortune* 500 firm and then compared their test results with their performance reviews. People who were more prone to guilt, he found, received higher performance ratings from their bosses. Related studies showed that they also were more committed to their organizations and were seen as stronger leaders by their peers.

The challenge: Is guilt good? Would companies benefit from putting more neurotic people, and fewer ultrarational types, into leadership roles? Professor Flynn, defend your research.

Flynn: From a researcher's perspective, the correlation is stunning. There's a lot of "distance" between the TOSCA [Test of Self-Conscious Affect, which assesses guilt-proneness] and the performance measure. They're completely independent. Yet in the research that my coauthor, Rebecca Schaumberg, and I have done, the link between guilt and performance is clearly there. Not only that—in a follow-up study we found that more guilt equaled more commitment. Those who felt guilty worked harder and were more likely to promote the organization to others. And one surprising finding was that guilt-ridden people were more likely to accept layoffs and carry them out.

HBR: Wouldn't those people feel too guilty about the fact that other people were losing their jobs to handle layoffs well?

It's not that they don't feel guilty about laying people off; it's that they feel obligated to support their employer, so they accept layoffs as a way to reduce costs. They feel it's their job to be "good soldiers," and if that means laying off a few to protect the interests of the many, that's what they'll do. In short, they're more sensitive to the overall goals of the firm. They see the forest for the trees.

So guilt-prone people are hardworking high performers who believe in the organization and see the big picture. In other words, they're leaders.

Exactly. In another study, we had 200 or so MBA students take the TOSCA survey and had their former coworkers rate them on leadership behaviors, such as the ability to lead teams. The students who were more guilt-prone were considered better leaders. Our take is that guilt activates a keen sense of responsibility for one's actions. What I wonder is, Does guilt make people better leaders but, at the same time, make them averse to taking on leadership positions because they feel that responsibility? We don't know yet.

Why study guilt?

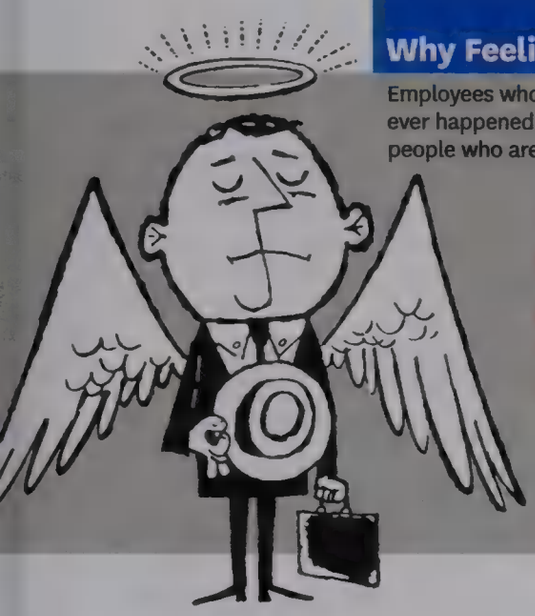
I asked myself, "What are the less intuitive characteristics that make someone a good employee?" We've researched to death the predictable ones. Everyone knows that people who are conscientious are good workers. But would we assume that guilt is part of the secret sauce for the ideal employee? Probably not.

Is guilt widely studied?

In psychology, yes. But in organizational research, it's noticeably absent, which is kind of surprising because you've got all these performance expectations in organizations, and we're not studying how people respond emotionally when they fail to meet them. That seems to be a real oversight. Maybe organizational researchers just assumed that guilt couldn't be constructive.

So if organizations start inducing guilt in employees, they'll end up with harder-working, more-loyal staffs?

Inducing guilt can sometimes backfire by eliciting resentment, but it can also be highly effective. If it weren't, then why is my mother so good at it? That doesn't mean managers should try to inspire guilt or that the approach would work long-term. One thing we haven't mentioned is that while there are benefits to guilt, there are probably costs as well.



Why Feeling Bad Is Actually Good

Employees who have guilty tendencies could be the best thing that ever happened to your organization. Flynn's studies found that people who are prone to guilt are more likely to be

- Harder workers
- Better leaders
- More altruistic and willing to help others
- Higher performers
- More committed to their employers
- Able to see the big picture

What costs?

Well...we haven't actually found some of the costs we expected to find. We thought, "They're working so hard, maybe they have lower job satisfaction." They don't. "Are they more stressed?" They're not. It appears that guilt-prone people are good at alleviating their negative feelings. But we still believe there may be costs associated with guilt. We just need to explore other possible disadvantages. One way might be to look beyond work. OK, so guilty people are harder workers, but

We see a connection between guilt tendencies and altruism. The guilty are more willing to assist colleagues in need.

does this commitment spill over into their personal life so that they're less able to relax at home?

Hard workers. Good leaders. Not stressed. Can manage feelings. Guilt-prone people sound like model citizens!

They may be more selfless as well. We see a strong connection between guilt tendencies and altruistic behavior. The guilty are more willing to make charitable contributions and assist colleagues in need. There seems to be a link between guilt and positive social behavior.

You and I both were raised Catholic. How are we not running major corporations with large philanthropic foundations by now?

We purposely stayed away from religion in this research. We don't have any empirical evidence of a link between guilt and certain religious denominations.

What else do you want to learn about guilt?

Right now we're looking at guilt and absenteeism. Take the retail sector. Low guilt may be a good predictor of employees' playing hooky. Conversely, guilt-prone people might practice presenteeism—showing up for work when they're sick. We're also interested in how people reconcile multiple foci of guilt. What happens when a manager feels compelled to stay late to ensure that a key project is completed on time but also feels obligated to go home and spend more time with their kids?

The TOSCA survey is designed so it's hard for subjects to tell what it measures. The finance staffers you used as guinea pigs didn't know what you were studying. Be honest: You feel a little guilty about that.

I was sitting with the CFO of the company, and he was going over the TOSCA questions and looking perplexed. He said, "Do you really think this is going to predict anything?" I felt somewhat guilty because I could tell he thought this was a waste of time. He was just peering at me incredulously, like I was this ridiculous academic. Which, of course, I am. But then he let me do it, and we wound up finding some amazing results, so now I don't have to feel so guilty anymore.

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Vision Statement

Multitaskers May Be Advertisers' Best Audience

Data by **Dan Zigmond** and **Horst Stipp**
Visualization by **Open**

Dan Zigmond oversees quantitative analysis and data warehousing for YouTube and Google TV Ads. **Horst Stipp** is senior vice president of strategic insights and innovation at NBC Universal. **Open** is a design studio in New York.

Many media strategists have been so busy bemoaning the demise of the television commercial that they've failed to spot a new opportunity: People are combining TV watching and internet use in ways that could be highly valuable to advertisers.

Yes, consumers watch less live TV than in the past and spend more time looking at other screens. And yes, many viewers—nearly 60%, a figure that's sure to rise—sometimes use their PCs or smartphones simultaneously. But these technologies are not just distractions; our data show that multitaskers often *do* pay attention to TV ads, and when a product or an offer piques their interest, they go online to learn more.

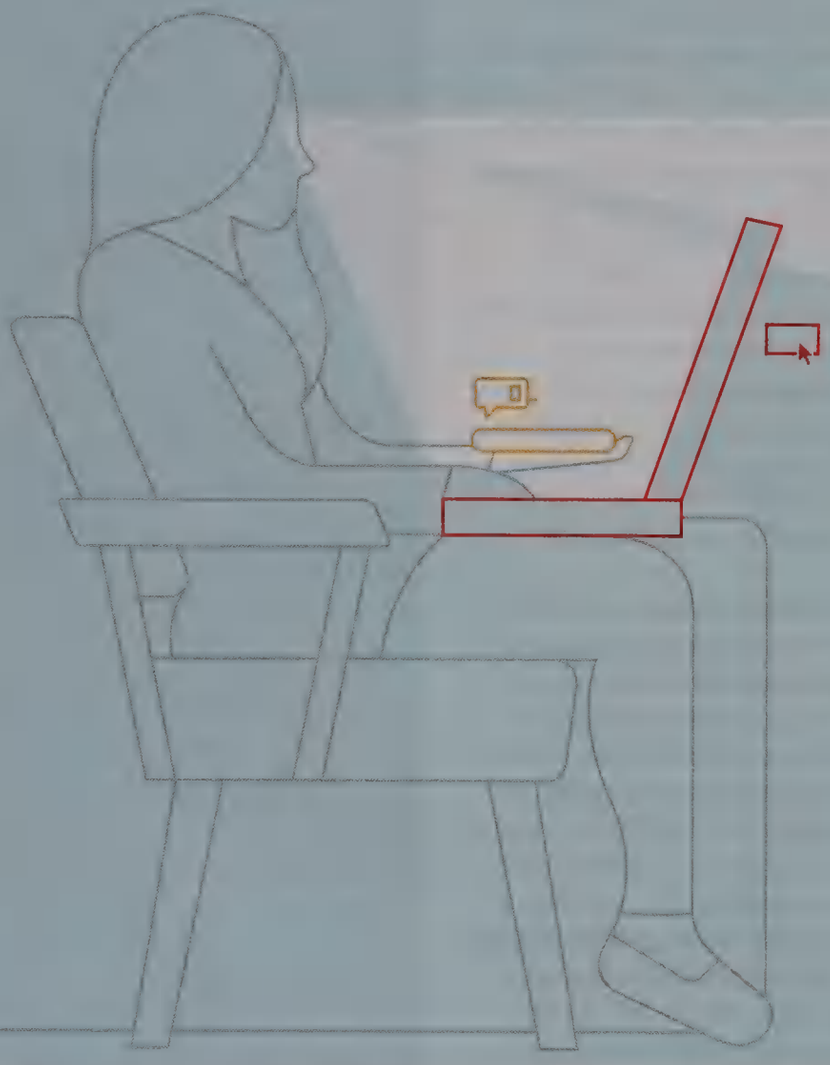
That finding is crucial for advertisers, who, after all, want consumers not just to absorb commercials but to act in response. If multitaskers are often taking what they see on TV and running to the internet, smart advertisers will be a step ahead, waiting for them there.

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Overlapping Consumption: A New Golden Age of Media?

Consumers in one study squeezed 12 hours of media exposure a day into 9 hours.

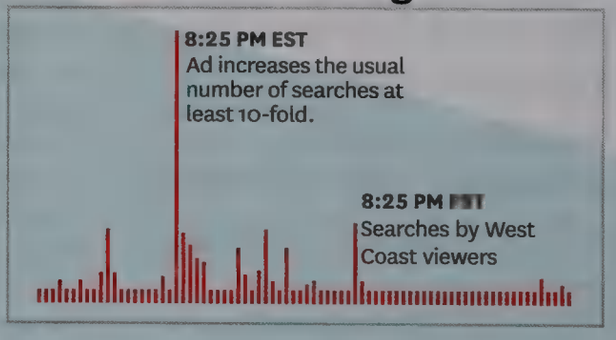
SOURCE MIDDLETOWN MEDIA STUDIES, BALL STATE UNIVERSITY



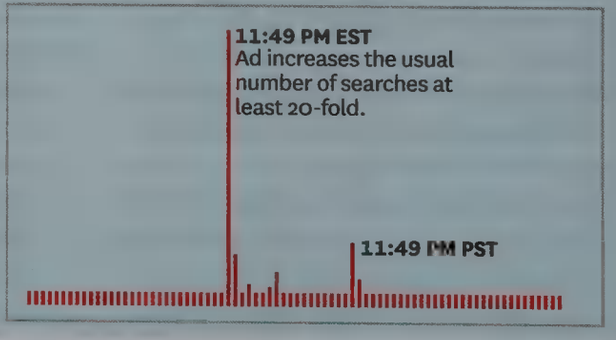
Watch the Spikes

Google search patterns during the broadcast of the 2010 Olympics opening ceremony show that viewers wanted to learn more about what they saw during commercials.

MOVIE
How to Train Your Dragon



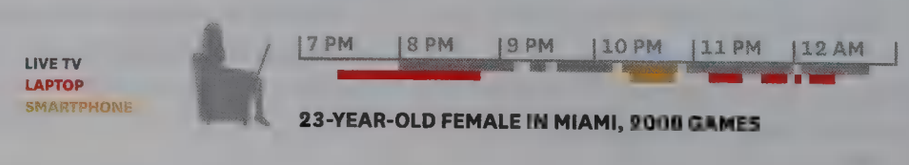
ELECTRIC CAR
Nissan Leaf



Dual Screens, Not Dueling Screens

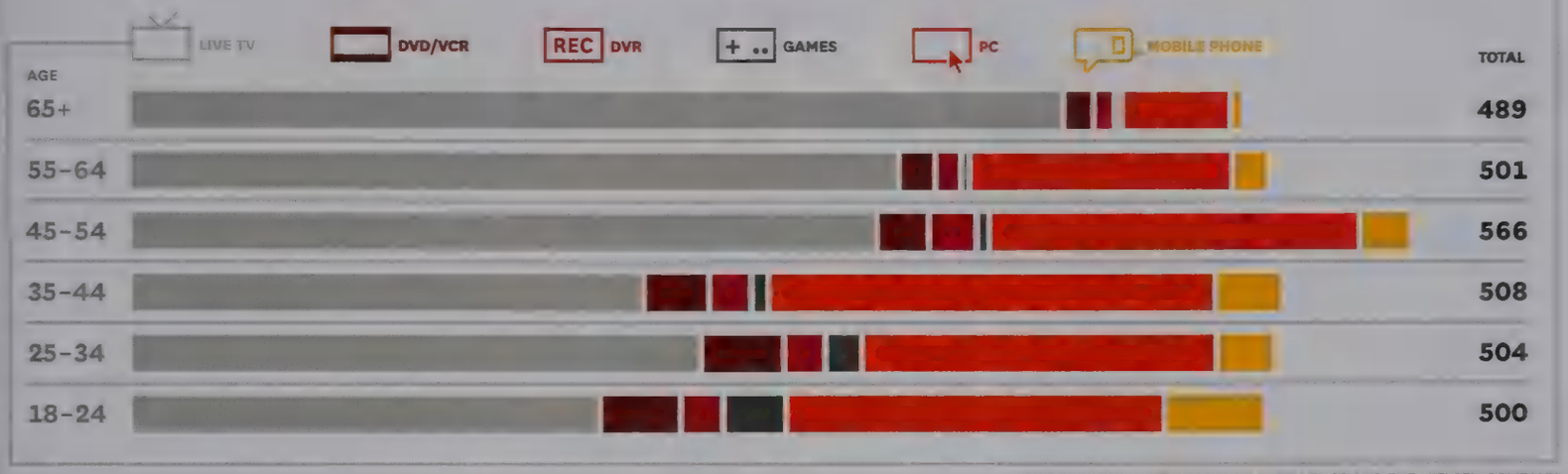
Data on specific individuals' viewing of prime-time Olympics coverage show that they watched on their laptops or smartphones *in addition to*, not instead of, their TVs.

SOURCE IMMI



Younger Viewers Watch Less Live TV but More of Everything Else

Average minutes per day spent on...



SOURCE COUNCIL FOR RESEARCH EXCELLENCE AND THE NIELSEN COMPANY

More Screens *and* More TV

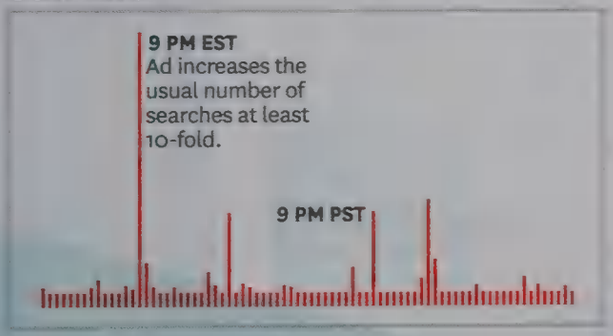
Conventional wisdom says that heavy users of PCs and smartphones watch less TV than others. But during a big event like the Olympics, multitaskers watch

2 to 3 times as much TV as TV-only viewers.

SOURCE ARBITRON, OMNITURE, AND COMSCORE

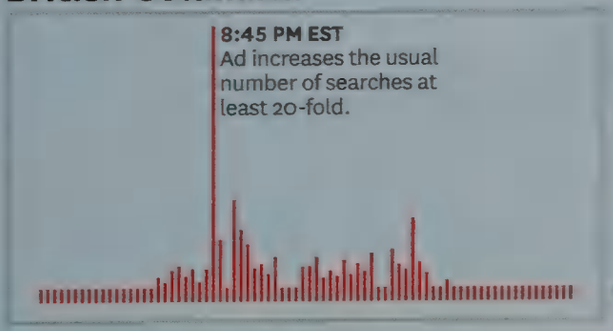
FINANCIAL SERVICES COMPANY

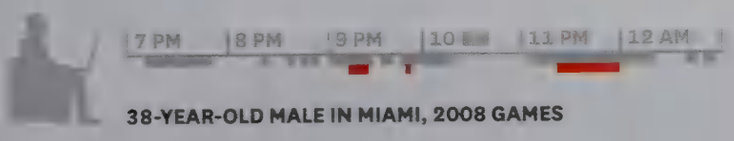
Sun Life



TOURIST DESTINATION

British Columbia





38-YEAR-OLD MALE IN MIAMI, 2008 GAMES



43-YEAR-OLD MALE IN SAN FRANCISCO, 2010 GAMES

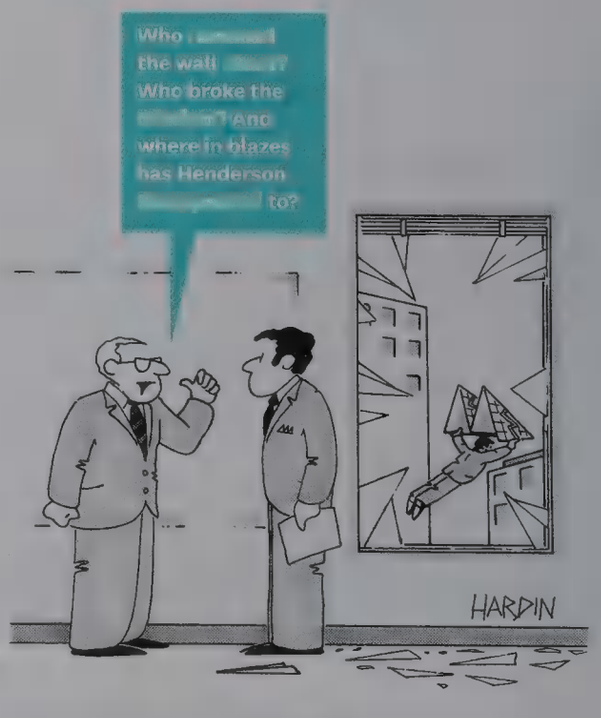
Strategic Humor



"Stressful conversations differ from other conversations because of the emotional loads they carry. [They] call up embarrassment, confusion, anxiety, anger, pain, or fear—such anxiety that most people simply avoid them."

Holly Weeks
"Taking the Stress Out of Stressful Conversations"
July–August 2001





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Lynda Gratton is a professor of management practice at London Business School, where she directs a research consortium focused on the future of work.

The End of the Middle Manager

The technology revolution has brought us a lot—dramatic improvement in what we know about customers and how we interact with them, markedly better information for making decisions, the ability to work through virtual teams scattered around the globe. But its unseen legacy might be something much more fundamental: It has changed the very nature of how people work. One consequence seems clear: The classic job of the middle manager will soon disappear.

In a way, we've come full circle. The Industrial Revolution—arguably equivalent to the technology revolution that has now swept the world—mechanized work in a way that destroyed much of the old order. Previously, the people who created the most value were craftsmen. They spent many years as apprentices, deeply learning their craft and earning the respect of their peers, before becoming masters themselves to other apprentices. The Industrial Revolution automated many of their highly developed skills, leaving the majority of jobs requiring only the shallow general skills that kept things running smoothly rather than created and innovated.

Now technology itself has become the great general manager. It can monitor performance closely, provide instant feedback, even create reports and presentations. Moreover, skilled teams are increasingly self-managed. That leaves people with general management skills in a very vulnerable position. In the past their networks and abilities were built up in one company—but as tenure with a single company decreases, people lose the opportunity to develop deep knowledge that other firms might value. Plus, thanks to the internet and search engines, everyone now knows or can know something about everything. There is little competitive advantage in being a jack-of-all-trades when your main competitor might be Wikipedia.

Technology itself has become the great general manager. It can monitor performance closely, provide instant feedback, even create reports.



Attitudes toward management have also changed. As my research makes clear, Gen Y workers see no value in reporting to someone who simply keeps track of what they do, when much of that can be done by themselves, their peers, or a machine. What they do value is mentoring and coaching from someone they respect. Someone, in other words, who is a master—not a general manager.

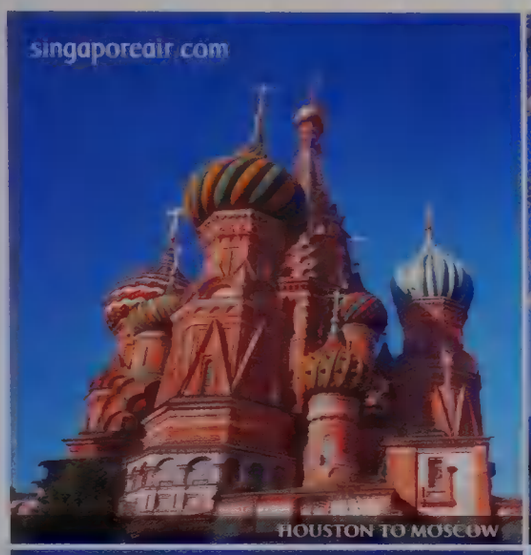
What does this mean for you? If you're a middle manager now, you aren't doomed to early retirement. But you must be prepared to make two crucial investments. The first is in acquiring and building knowledge or competencies that are valuable and rare—what I would call your "signature." Without it you will become invisible, no longer propped up by the trappings of managerial life. Visibility will come not from the HR departments of the past but from the rapidly emerging guilds of the future. Some, like the virtual guilds Sermo (for U.S. physicians) and LawLink, already play the role of the medieval guilds by verifying skills and increasing knowledge.

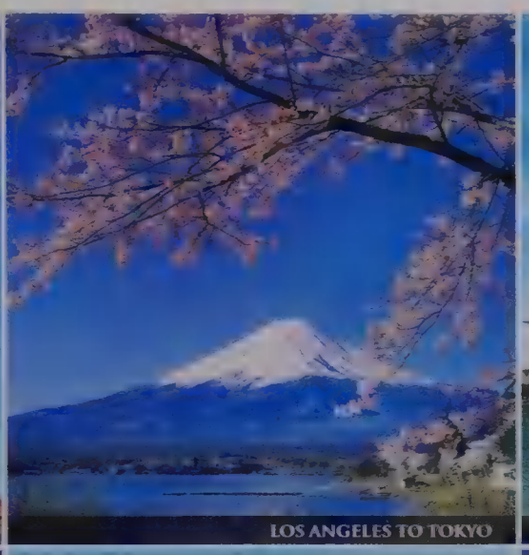
The second investment is in developing new areas of proficiency, or moving into adjacencies, throughout your working life. But in the future not all deep knowledge will be valued the same. It is important to think hard about which competencies are rare and difficult to imitate and which careers will be most successful. My research suggests that advocacy, social and micro entrepreneurship, the life and health sciences, energy conservation, creativity and innovation, and coaching will be highly prized in the decades ahead.

Are you future proofed?

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ILLUSTRATION: EMILIANO PONZI

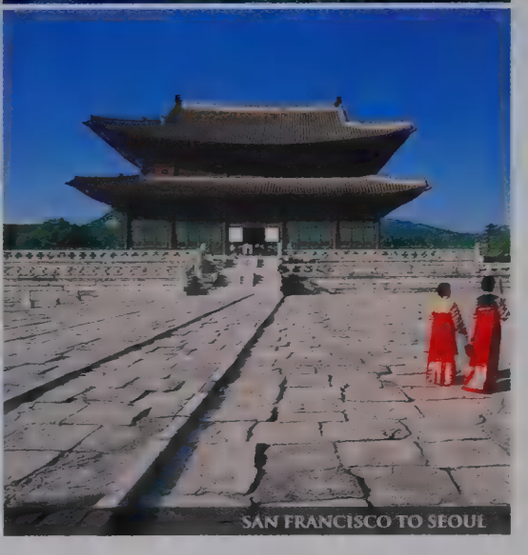












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Shane Frederick (shane.frederick@yale.edu) is an associate professor of marketing at Yale's School of Management.

The Persuasive Power Of Opportunity Costs

While shopping for my first stereo, I spent an hour debating between a $1,000 Pioneer and a $700 Sony. Perhaps fearing that my indecision would cost him a sale, the salesman intervened with the comment "Well, think of it this way—would you rather have the Pioneer, or the Sony and $300 worth of CDs?"

Wow. The Sony—and by a large margin. Twenty new CDs were too great a sacrifice for the slightly more attractive Pioneer. Although I could subtract $700 from $1,000 and was capable—in principle—of recognizing that $300 could be used to buy $300 worth of CDs, I hadn't considered that until the salesman pointed it out.

If one assumes, as an economics textbook might, that consumers routinely calculate opportunity costs, this anecdote should be revealing. All decisions involve opportunity costs, but the way consumers reckon them has received little attention from decision theorists and even less from marketers. Promotional messages often highlight the advantages of one product over another (A is 50% faster than B; X is $300 cheaper than Y), but spelling out the implications of those differences may be more persuasive: Price differences can look large or small, depending on what else one imagines purchasing with that money.

Though opportunity costs seem underused as a rhetorical tool of marketers, they were famously invoked by Eisenhower in his 1953 "Chance for Peace" speech: "The cost of one modern heavy bomber is this: a modern brick school in more than 30 cities....We pay for a single fighter with a half million bushels of wheat. We pay for a single destroyer with new homes that could have housed more than 8,000 people." By contrast, references to opportunity costs were notably absent in a speech George W. Bush delivered 50 years later in the run-up to the Iraq war: "[W]hile the price of freedom and security is high, it is never too high. Whatever it costs to defend our country, we will pay."

Price differences can look large or small, depending on what else one imagines purchasing with that money.

Generally, firms selling cheaper products should trumpet the opportunity costs of trading up, while those selling expensive ones should keep quiet. But the concept must be wielded with care. The same logic that leads people to choose the silver over the gold could lead them to choose the bronze over the silver.

Moreover, the lost opportunities one highlights should be something the decision maker values. An ostensibly antiwar website described the cost of the war in Iraq (then estimated at $300 billion) as "the loss of nine Twinkies per American per day for a year." Come again? The peaceniks had unintentionally persuaded me that the war might be a bargain. This comically ineffective comparison suggests a strategy for those offering expensive products or policies: Cast the opportunities given up as something unattractive or unimportant. An ad by De Beers did this brilliantly. It depicted two large diamond earrings with the tagline "Redo the kitchen next year." Clever. It implied that the cost of the diamonds was merely a slight delay in a renovation. In fact, if a consumer spent the money reserved for the kitchen on the diamonds, it might take him or her much more than a year to save that amount again.

A widely accepted precept in research on decision making is people's passive acceptance of the "frame," or characterization of the problem, they're provided. This confers power on those who offer a frame. Decisions about whether some expenditure is "worth it" hinge on what the purchase is seen as displacing. Take the extra time to define that, and you can change the way your customers view your value proposition.*

*My editor suggested that I could write this column in the time it would take me to watch a sitcom. In fact, by the time I completed it (amid distracting giggles coming from my daughter as she played downstairs), I realized that I could have watched half a dozen sitcoms.

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ILLUSTRATION: RYAN SNOOK

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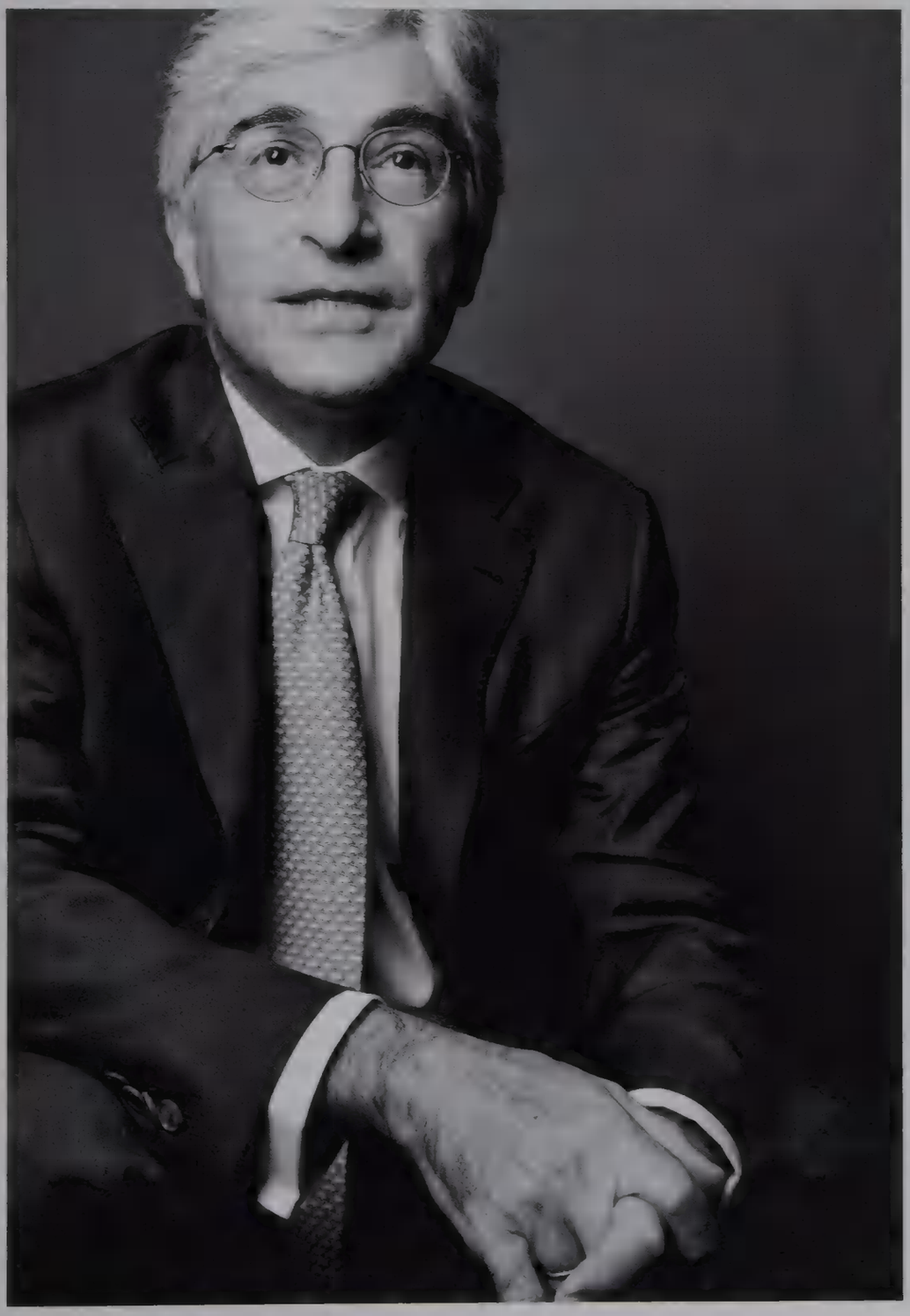
On the surface, this appears to be a majestic yet harmless ice formation.

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How I Did It...

Maclaren's CEO on Learning from a Recall



PHOTOGRAPHY: PETER MURPHY

by Farzad Rastegar

THE IDEA

Though Maclaren USA had spent months carefully planning a recall, when the news leaked a day early, the company was unprepared. What followed taught its CEO some valuable lessons.

Like many CEOs, I subscribe to a daily e-mail service that notifies me when my company is mentioned in the news. On the morning of November 9, 2009, a Monday, the first headline I saw was "Maclaren Stroller Recall."

The story, from the New York *Daily News*, went on to explain that Maclaren USA, a business I've run since 2001, was recalling one million strollers following finger injuries to 12 children. The information about the recall was true. But I hadn't expected to read about it in the paper that day.

Maclaren had been planning to release a statement to the same effect on November 10, following guidelines set by the U.S.

As the news spread, our communications systems first jammed and then crashed. E-mails went into the ether. Our website froze.

Consumer Product Safety Commission. But the news had somehow leaked out ahead of schedule—and in my opinion, the spin was unfair and inaccurate. Maclaren had not been ordered to take faulty strollers off the market. We were voluntarily responding to an increase in reports of children's fingertips being caught, pinched, bruised, or cut, primarily in the saddle hinges of two of our models. Some cases had involved laceration or distal amputation. These incidents took place only in the United States, involved only two of our models, and had occurred not when the strollers were in use, with the children strapped in, but when caregivers opened the devices without realizing that their charges were close enough to reach in. For several months we had worked with the CPSC on a plan to make owners more aware of the danger and to provide protective hinge covers for all our models (including those not associated with the reported incidents) to anyone who wanted them—unquestionably the right thing to do. But the news story provided none of this context. Nor did it explain that practically *all* strollers on the market have similar hinges.

That morning I immediately got dressed, headed into the office, and called my senior executives and the recall project team to talk about a response. My first concern was correcting what was now a rapidly spreading misperception. Other news outlets had picked up the story; customers were already calling us, many of them understandably upset or worried. We had hoped that the recall would build awareness about the wider risks of operating a stroller—not just about hinges. Instead we would have to start defending our brand. But we were reluctant to speak publicly without CPSC approval. We contacted the agency to see if we could release our statement early. The regulators took a few hours to come back to us with a yes, but by then we were already playing catch-up.

We also had a larger, more damaging problem. The experts advising us, including the CPSC, estimated that in the first 30 days of the recall we would get 50,000 requests for hinge covers, representing 5% of the one million strollers we had on the market. To be safe, we had prepared for more than twice that; hired extra people to handle calls, e-mails, and fulfillment; and arranged for cloud-computing capacity so that our website wouldn't be overloaded. On November 9, however, none of this was ready to go. It was a colossal oversight; we should have anticipated a leak, or at least been prepared well in advance.

As the news spread, prompting thousands of concerned parents to contact us, our communications systems first jammed and then crashed. Callers got a busy signal. E-mails went into the ether. Our website froze. The showroom at our headquarters in South Norwalk, Connecticut, was closed, because Monday is a day off for the on-the-floor sales team, so when a television crew from the local ABC affiliate showed up, peered into the dark windows, and then started to leave, I had to run down from my second-floor office to catch the reporters.

Communicating through personal mobile phones and e-mail addresses, my colleagues and I assessed the situation. Our IT team was working feverishly to bring our systems back. We immediately realized that we would need more of everything. We had hired 10 extra people; we would need 40. We'd produced 125,000 hinge covers; we would need more than triple that number. We were in triage, dealing with one issue after another, and the frustration was deep. We'd been preparing to execute on the recall for months. We were like athletes forced to play the big game a



Meglena Kuneva, the European commissioner for consumer protection, with Farzad Rastegar, Brussels, December 2009

PHOTOGRAPHY: COURTESY OF EUROPEAN COMMISSION

day early—in the rain. Everyone was out of breath. And things stayed that way for at least two weeks, until nearly all customer communications had been recovered and we were airlifting additional hinge covers from our production center.

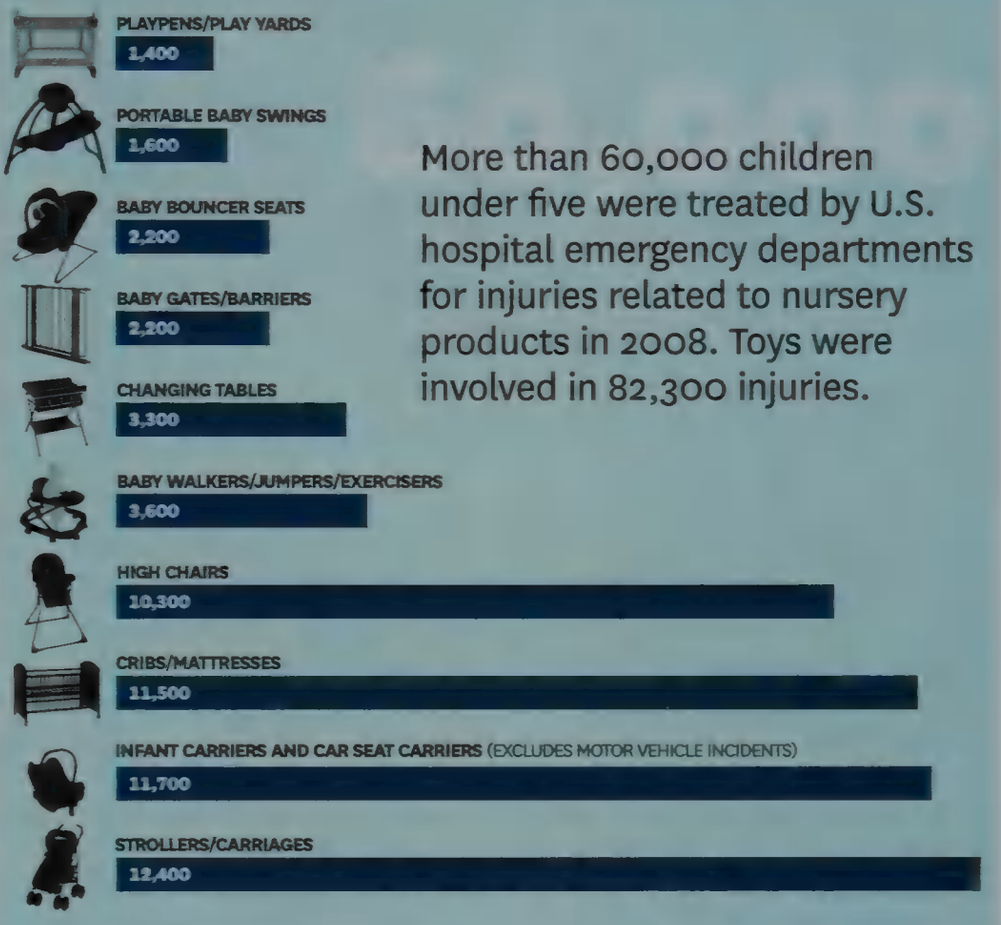
Safety First

Having a safety recall at Maclaren—let alone one that went off track—was particularly painful for me. My first experience with the company had been as a parent, years before, after a stroller I'd bought for my daughter, a top-of-the-line brand, collapsed in the middle of New York City's Fifth Avenue. My London-based sister-in-law recommended that we get a Maclaren instead, a brand then available mainly in the UK. We did, and I was so impressed with its quality that I started to do some research on the company. Founded by Owen Maclaren in 1945, the business was based in Northamptonshire and employed nearly 500 people. I was working in my family's investment company at the time, looking for opportunities. This seemed like the perfect one. We acquired the company, and I became the CEO of the U.S. business.

Maclaren's top priority has always been safety. Everyone talks about how expensive and fashionable our strollers are relative to other umbrella models on the market, but that's because they are made with the strongest and best materials and tested to the highest standards in the industry, even in the absence of regulatory requirements in the United States and many other countries. A child is a child no matter where he or she lives, and safety should never be compromised. Parents the world over get exactly the same models as parents in America.

Largely because of this commitment to quality, Maclaren has had great success. It is a leading brand, with engineering and licensing headquarters in Hong Kong, a design center in the UK, outsourced manufacturing, and a network of distributors, many of them independently owned, in various regions. This structure has served the company well in a number of ways. Centralized product and brand management ensures consistent quality, while local sales and communications teams can decide what strategies work best for their markets. But during the U.S. recall crisis, the lack of an overarching management body made global coordination difficult.

An Industrywide Problem



Unwelcome Delay

After we discovered the rise in reports of finger injuries in the U.S., we appointed an investigative team to look into the matter. Then, after much consultation and brainstorming with my counterparts around the world, consistent with Maclaren's global approach to product development, we decided that the company must take action in two ways. First, we would enhance or add warnings on all our strollers and in all our instruction manuals worldwide. Second, we would approach regulatory bodies in the U.S. and other markets where appropriate.

We sent a report to the CPSC on July 9 and asked for a meeting. Several weeks later the agency gave us a date—August 12—so we pulled our engineers and executives from their summer vacations and convened. We made a pitch for releasing a protective hinge cover in time for the annual industry trade show in Las Vegas in September. As a voluntary recall, the process could have been completed in three weeks. However, we finally had to settle with the CPSC on a go-live date of November 10. Our technical review and testing of the hinge cover design were completed by September; in our view, the back-and-forth with the CPSC was slow. Perhaps the delay involved a debate over how to deal with a potential industrywide risk when only one brand had exposed the problem. Or maybe the agency had broader concerns about how to regulate a consumer product category that has no mandatory minimum standards in the U.S.—even though it is second only to toys in causing injuries to children under five. Maclaren's aim was not only to execute the recall but also to make parents more aware of the safety issues. In the months leading up to November we had invested in many things: product safety

ILLUSTRATION: SHUTTERSTOCK, VECTOR STOCK, ISTOCK PHOTOGRAPHY

Five Biggest Stroller Recalls

The U.S. Consumer Product Safety Commission has announced 46 recalls of strollers or stroller accessories since 1977. Here are the top five as measured by number of units involved.

2,000,000 UNITS
OCTOBER 20, 2010
GRACO: 5 INJURIES, 4 DEATHS

1,500,000 UNITS
JANUARY 20, [illegible]
GRACO: 7 INJURIES

1,140,000 UNITS
JULY 7, 2005
GRACO: 264 INJURIES

1,000,000 UNITS
NOVEMBER 9, [illegible]
MACLAREN: 12 INJURIES

650,000 UNITS
JUNE 14, [illegible]
CENTURY: 250 INJURIES

SOURCE USCPSC

experts, producing and transporting hinge covers, consultant project managers with MBAs to oversee the recall, extensive outreach to retailers, and the aforementioned additional staff and technical support. We did not invest in crisis management or communications advice. Given our reputation for safety and our work with the CPSC, we thought the PR would handle itself and that our money would be better spent supporting the recall.

A Sensationalist Leak

We were wrong. If we had hired the right advisers, we might have learned how easily an early, sensationalist leak could occur and then prepared a comprehensive response strategy for any scenario. We had in fact raised the question of confidentiality with the CPSC, because according to its regulations, retailers had to be informed about the recall in advance. They were supposed to wait until our announcement before releasing any information—but unfortunately, that guideline was no guarantee. When the news broke, our reaction was completely ad hoc. Aside from the interview with the local TV crew, I spoke to no press representatives that day. When I got home, my wife pointed me to a thoughtful blog post by Julia Kirby on the HBR website, and because I was so impressed with the clarity of its analysis, I responded to it. A few days later I gave an interview to the *Financial Times*. But even this limited outreach was criticized in the press ("Why does Mr. Rastegar have time for interviews in the midst of a product recall?"), so my colleagues and I decided, mistakenly, that I should stop talking. Instead our marketing manager, Charlotte Addison, who had started her job only weeks before the recall announcement, fielded press calls and worked to get our message out on parenting websites. It was a struggle to keep up with sometimes erroneous and sometimes vicious reporting.

Undoubtedly, a PR expert would also have predicted the vehement emotional response and the global fallout. In Canada, Britain, Europe, and Japan, reporters, regulators, and parents were asking why Maclaren hadn't "recalled" its strollers from their countries, too. We had in fact asked the CPSC about the need for global action. Its response was that the injuries were in the United States, Maclaren USA was an American company, and American protocols must be observed. We had misgivings about that approach, but we followed the CPSC's lead. In hindsight, that was a bad decision. For one thing, the term "recall" has different meanings in different countries. For example, in the U.S. it means any corrective action, including one like issuing hinge covers, but in the UK it is a faulty product that must be returned for a refund or replacement.

> Given our reputation for safety and our work with the CPSC, we thought the PR would handle itself. We were wrong.

The negative reaction was like an explosion from one market to the next. And because of Maclaren's decentralization, it was difficult to craft a global response. The Canadian distributor didn't want to do anything. The UK business was desperate to talk to the press. When the European Commission requested a meeting, I was the person dispatched. Eventually we decided that Charlotte would be the global point person for the press, and I would handle dealings with regulators.

We did hire a big PR firm in the middle of the crisis, but that, too, turned out to be a mistake. The firm's advice—which ranged from making an apology to limiting my personal appearances in the media because of my "foreign" accent (I'm of Persian origin)—was out of line with my desire to defend the fundamental safety of our products and to communicate directly and openly with our customers.

Valuable Lessons

As I look back at the period following that initial *Daily News* article, I think it was probably one of the most difficult times in my business life; certainly it was the worst in Maclaren's history. But good did come of it. I've learned a lot about myself, my role as CEO, and what it means to lead a growing global company.

First, I have a new admiration for all our stakeholders—retailers, customers, and employees. I am constantly humbled by how intelligent, reasonable, and supportive

they are. Even during the crisis, many parents blogged testimonials, and stores such as Mothercare in the UK issued statements of support. Meanwhile, our employees performed exceptionally well under enormous pressure, and many of the extra hires have stayed on. Our business did take a hit in the U.S. right through February 2010, but we think that was owing more to postrecall policy problems with a few big retailers than to customers' refusing to buy Maclaren's products. Overall, our sales around the world have remained strong, and our brand continues to enjoy passionate support from customers. Everyone at the company has been reminded how important it is to stay true to our safety-first values.

Second, the recall demonstrated to Maclaren's senior management team that the company must become more cohesive. We are working on an initiative called One Maclaren, with the goal of owning nearly all distribution under a single global umbrella by the end of 2011.

Third, and most important, we have realized that Maclaren must play a bigger leadership role in the industry, mobilizing other brands, manufacturers, retailers, and regulators around the world to work toward mandatory minimum global standards with common definitions, harmonized procedures, and uniform protocols. In the United States strollers remain one of the very few major consumer goods categories with no regulations. We have already approached our key partners and are preparing a set of proposals. The CPSC is moving toward regulating more children's products and has set a timetable for implementation. The safety of children, however, is an international issue.

Thanks to the recall, we have realized that Maclaren is a tiny company with a giant name. We can have an impact on our industry; we can keep our children safe and make their parents more aware. We were never in an advocacy position before, but we are now—and obsessively so.

HBR Reprint R1101A

Farzad Rastegar is the CEO of Maclaren USA.

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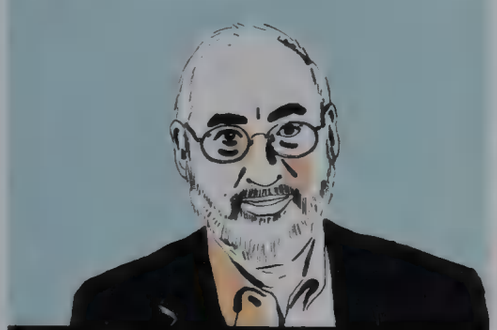
IN THE SPIRIT OF THE NEW YEAR, we asked two dozen business and management leaders what projects they'll take on in 2011. Here they share their answers—which range from shaking up the study of economics to lifting the quality of discussion on the internet. We expect these people to make significant headway during the year, and we hope their efforts will inspire HBR readers to pursue similarly lofty projects.

THE HBR AGENDA 2011

MACROECONOMICS

JOSEPH E. STIGLITZ

LEARNING HOW THE ECONOMY REALLY WORKS



The economic crisis has resulted, or should have resulted, in a crisis in economics—in the prevailing ideas about how economies function. The dominant macroeconomic paradigm not only failed to predict the crisis but said that such a crisis could not occur in rational markets with rational expectations. Monetary and regulatory policies predicated on this prevailing view were central to the creation of the crisis.

For decades I have been engaged in a critique of the standard paradigm, attempting, for instance, to construct models whereby rational individuals interact with imperfect and asymmetric information. The results have been devastating for much of the conventional wisdom. For instance, with Bruce Greenwald, I showed that the reason Adam Smith's invisible hand often seemed invisible was that it was not there: Markets in general were not efficient when information was imperfect and asymmetric or risk markets were not complete—which is to say, always. With Sanford Grossman, I showed that financial markets could not be informationally efficient; if they were, perfectly transmitting information from the informed to the uninformed through prices, no one would have any incentive to gather information. With Andrew Weiss, I explained why financial markets were often characterized by credit rationing.

More recently, I have begun researching the implications of these microeconomic advances for macroeconomics—for movements in GDP and unemployment and for policies designed to stabilize the economy and maintain it at close to full employment with robust growth. The financial crisis, and the failure of policies to restore the economy to full employment or even to restart lending, give new urgency to this research program, which will be the focus of my efforts over the next year.

The task of constructing a new paradigm is, of course, enormous; but we are fortunate in that the building blocks have been under development for the past two decades. One is the study of market "imperfections" that arise out of imperfect and asymmetric information. Another is the growing field of behavioral economics, which focuses on the many ways in which individual behavior differs from that predicted by models that assume full rationality.

> Adam Smith's invisible hand often seemed invisible because it was not there.

There is a saying that old ideas, no matter how thoroughly discredited, die a slow death as, one by one, their advocates pass away. For economics, the battle is over young minds. At Columbia we expose our students to a wide variety of approaches. Increasingly, they are asking why they should waste time learning ideas and models that are clearly misguided. I take this as a hopeful sign—encouraging me and others to redouble our efforts. The recently established Institute for New Economic Thinking (INET) is providing resources and a global platform that may make the possibility of creating a new paradigm a reality.

Joseph E. Stiglitz is a university professor at Columbia and the winner of the 2001 Nobel Prize in economics.

MANAGEMENT

HERMINIA IBARRA

FINDING HARD WAYS TO MEASURE "SOFT" LEADERSHIP



Management thinkers have been heralding new models of leadership for some time. We're fond of asserting that "command and control" is out, replaced by distributed leadership, empowerment, knowledge networks, and a premium on lending meaning to people's work. But in practice these ways of leading are still viewed as indulgent; when performance pressures become uncomfortable, many managers revert to hard-edged authority, making clear that they consider these new approaches "nice to haves," not necessities to compete. This is particularly true in settings where clear role models, accepted metrics, and action guidelines for how to succeed are absent. The pressing question, then, is: Can we provide hard evidence of the benefits of "soft" leadership?

Last year my Insead colleagues Morten Hansen and Urs Peyer and I, using the hardest of evidence, identified the CEOs who had added the most value to their companies in the past decade. (See "The Best-Performing CEOs in the World," HBR January–February 2010.) Our method looked at how performance metrics such as total shareholder return and market capitalization changed annually, on average, across a CEO's tenure. With the quantitative question of who added value now settled, we can turn to the qualitative question of how they did it. Our next project will merge our database with data collected by others on practices consistent with new leadership approaches. (Several established indices monitor behaviors that

ILLUSTRATION: VINCENT BOUCHARD; OLIVIER BALEZ; BARRY FALLS

contribute to sustainability, innovation, and other outcomes.) In the cross-section we will identify models of new leadership that deliver bottom-line results.

By researching these highly innovative and top-performing corporate leaders in depth, we hope to provide hard evidence that their successes are due to—not in spite of—their approach to leadership. Perhaps more important, the close study of their cases will help us develop a picture of how the different values they pursue come together to form a viable new paradigm of leadership.

Why is all this important? If we can figure out what great leadership looks like

Distributed leadership, empowerment, and knowledge networks are still viewed as indulgent.

in today's world, we may be able to predict which leaders will add the most value to their organizations in the coming decade. As management educators, we might also learn how best to develop the generation of leaders who will take charge of our largest, most powerful companies. ■

Herminia Ibarra is the Cora Chaired Professor of Leadership and Learning at Insead.

TECHNOLOGY

ERIC SCHMIDT
PREPARING FOR THE BIG MOBILE REVOLUTION



As I think about Google's strategic initiatives in 2011, I realize they're all about mobile.

We are at the point where, between the geolocation capability of the phone and the power of the phone's browser platform, it is possible to deliver personalized information about where you are, what you could do there right now, and so forth—and to deliver such a service at scale.

But to realize that vision, Google needs to do some serious spadework on three fronts. First, we must focus on developing the underlying fast networks (generally called LTE). These will be 8-to-10-megabit networks, roughly 10 times what we have today, which will usher in new and creative applications, mostly entertainment and social, for these phone platforms.

Second, we must attend to the development of mobile money. Phones, as we know, are used as banks in many poorer parts of the world—and modern technology means that their use as financial tools can go much further than that.

Third, we want to increase the availability of inexpensive smartphones in the poorest parts of the world. We envision literally a billion people getting inexpensive, browser-based touchscreen phones over the next few years. Can you imagine how this will change their awareness of local and global information and their notion of education? And that will be just the start. ■

Eric Schmidt is the chairman and CEO of Google.

HEALTH CARE

MICHAEL E. PORTER
DISCOVERING—AND LOWERING—THE REAL COSTS OF HEALTH CARE



The rising costs of health care are a pressing issue in the United States and elsewhere, but we can't reform the system without better ways of understanding the relevant costs and how to measure them. To achieve that, I'm pursuing a new initiative with my colleague Robert S. Kaplan to bring modern cost accounting to health care delivery.

To be sure, the health care system does not lack for cost data. Ask about costs at any level of health care provision, and you will be deluged. But we actually know very little about costs from the perspective of examining the value delivered for patients. In particular, we do not know the total cost that health care providers incur to deliver care for patients' medical problems. There are two big puzzles to untangle: how costs are aggregated, and how they are allocated.

With the first, the problem is that health care organizations divide their expenses into buckets that are not very useful for cost analysis. Care providers account for expenses incurred by departments, by physician specialties, or for discrete services. It's easy to record the costs of running a hospital's emergency room, radiology lab, cardiology department, or physical therapy center. What's obscure is the full cost of treating the patient's problem.

INNOVATION

VIJAY GOVINDARAJAN

DESIGNING A $300 HOUSE



In 2011 I intend to start something big by thinking small. I want to help create a $300 house. I first proposed the idea (with Christian Sarkar) on HBR's blog network. The response was overwhelming—a revelation. Thoughtful critiques poured in, and inspired volunteers wanted to contribute.

A $300 house would transform the lives of hundreds of millions of desperately poor citizens. It would turn strangers into neighbors, slums into neighborhoods. Despite the ultra-low price point, it could include basic modern services such as running water and electricity. More important, it would create a community that shared access to computers, cell phones, televisions, water filters, solar panels, and clean-burning stoves. In doing so, it would enable the poor to leapfrog the limits of slums. It would make healthy and safe living possible and a good education achievable.

The idea of regenerating slums is not new. In the past, however, the focus has been on potential solutions from NGOs and governments, on the assumption that the poor can't be customers.

That assumption is wrong. A $300 house is not charity; it's a challenge for commerce. Not only can the world's poor be relevant customers, but they represent the fastest-growing customer segment. Meeting their needs requires

CONTINUED ON PAGE 52

It isn't surprising that costs are aggregated in this way: In the U.S., in particular, it reflects how care is organized and paid for. Reimbursement is based on fee for service, with separate bills for each physician specialty, procedure, test, and so on. That makes meaningful reform difficult, however, because efforts to reduce costs naturally proceed from known costs. Cost-reduction initiatives involve incremental steps such as bargaining down reimbursement rates for specific services and attempting to limit expensive services and drugs. This approach has yielded marginal savings at best.

If we truly want to understand costs and where they can be reduced without compromising outcomes, we need to aggregate costs around patient cases. What matters is the total cost of treating a patient's medical condition, such as renal failure or breast cancer, not the cost of running a dialysis center or a medical oncology department. If all the costs involved in a patient's care—inpatient, outpatient, rehabilitation, drugs, physicians, equipment, and facilities—are brought together, it is possible to compare the costs with the outcome achieved. Armed with this knowledge, we are in a position to reduce structural costs by reallocating spending across types of services, eliminating non-value-adding services, better utilizing capacity, speeding up cycle time, performing services in the appropriate facilities, and so on.

This is the objective of pilot projects that Professor Kaplan and I are conducting with major health care delivery organizations. We are investigating total costs for a number of medical conditions, and also comparing total costs incurred to treat the same medical condition by two different providers, one in the U.S. and one in Germany. In Germany reimbursement for a total knee replacement is about $8,500, whereas in the U.S. it ranges from about $25,000 to $40,000. These are the prices that payers are presented with. Are the underlying costs so wildly different, and if so, why? Using current cost accounting practices, such comparisons are difficult (sometimes virtually impossible) to make. With proper cost measurement, however, we can ask the $30,000 question: How might the U.S. provider reduce the gap?

In addition to measuring costs around the patient, we need to address a cost allocation problem. Note that patient care involves not only the direct costs, such as a surgeon's time, drugs, or supplies, but the costs of utilizing shared resources. Indeed, shared personnel, facilities, and equipment account for much of the cost of health care delivery. Typically, these costs are charged out evenly across all patients, regardless of how much an individual patient actually draws on shared resources. The challenge, then, is to appropriately allocate shared resource costs to individual patients. It is a challenge tailor-made for the activity-based costing methods that Kaplan and his colleagues have pioneered.

Already our work is revealing opportunities for cost reduction. Much health care, we now see clearly, is delivered in overresourced facilities. Routine care, for example, is delivered in expensive hospital settings, where facilities are often idle and a lot of equipment is in place but rarely used. Skilled physicians and staff members spend considerable time on activities that don't depend on their expertise and training. The way care is currently organized leads to redundant administrative costs, unnecessary and expensive delays in diagnosis and treatment, and unproductive time for physicians.

All these observations make me optimistic that health care costs can be substantially reduced without sacrificing patient outcomes. In fact, cost reduction will often be associated with better outcomes. The introduction of modern cost accounting may turn out to be as much of a breakthrough in health care as it was in other industries decades ago. ■

Michael E. Porter is the Bishop William Lawrence University Professor at Harvard Business School.

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GOVINDARAJAN CONTINUED

breakthrough innovations that have to scale—something that multinationals know how to do. There are precedents: The Unilever subsidiary Hindustan Lever has transformed the distribution model for rural India, thereby bringing the enormous rural population of that country into the consumer base.

Multinationals cannot solve this problem alone. The poor should be viewed not as passive beneficiaries but as principal actors. Let's place them at the center and create ecosystems—including corporations, NGOs, and governments—that can build ultra-low-cost, high-value housing. We will have succeeded when business views the building of $300 homes and the servicing of their residents as a mega-opportunity, with billions in profits at stake.

Though a newcomer to affordable housing, I'm not naive about the challenges, such as insecure land tenure, political interference, and the world's schizophrenic attitude toward slums. Here is my agenda for 2011: (1) Build a movement with the help of thought leaders who write for HBR.org and 300house.com, addressing the challenge from every conceivable angle—slum-dweller empowerment, design, urban planning, land rights, finance, infrastructure, government policies, energy, and more. (2) Organize a summit focused on the $300 aspiration. I urge the best and the brightest—Jimmy Carter, Rahul Gandhi, and Vinod Khosla, among others—to join. (3) Travel to India with experts and executives to meet with slum dwellers and build a prototype in collaboration with them.

When I think about this idea, I think of my daughters. They are incredibly smart, but not necessarily smarter than a young woman living in India's filthiest slum. My daughters have what she does not—the chance to determine their own path. That's what the $300 house represents to me: not just opening the door to a home, but opening the door to a world of opportunity. I hope you share my passion. ■

Vijay Govindarajan is the Earl C. Daum 1924 Professor of International Business at Dartmouth's Tuck School.

BEHAVIOR



DAN ARIELY

OUR IRRATIONAL FEAR OF THE "UNNATURAL"

We see in people a huge bias toward "natural"—a preference for products thought of as unadulterated. For example, you may have read recently about the Boston company that created genetically modified salmon, which grow twice as fast as regular salmon and need less food. The new salmon offer many benefits: Local growing means less carbon is required to get them from stream to plate. They replenish in half the usual time, allowing more people on the planet to be fed. Why shouldn't we embrace genetically modified salmon as a sustainable, socially progressive idea? But resistance is deep-rooted and very strong.

I explain this resistance with what I call the caveman theory. Basically, people believe that in the caveman era our bodies were perfectly attuned to nature. Since then, technology has outpaced evolution, causing a misalignment between our bodies and the surrounding technologies. The same theory could explain an enduring resistance to synthetic medicines. They may treat a problem, but by working on us in nonnatural ways, they can have unintended consequences and bad side effects. We are disturbed by that.

Tackling the underlying issue here is critical as we try to achieve sustainable growth. To develop and support my caveman theory, I want to take my research in three directions.

First, I want to figure out which products we care more and less about in this respect. For example, it seems clear that no one cares whether a phone is natural, or eyeglasses. Most women have no problem with nail polish. With hair products, they have a little more concern. With lotions, even more. I suspect that the more products interact with the inner workings of our bodies, the more we care about naturalness.

Second, I'm testing expectations about side effects, hypothesizing that consumers believe that although artificial medications may be more potent than natural ones, they will have more side effects.

Third, I will examine whether "more natural" leads to more compliance—that is, do more people follow a healing regimen if it is framed as natural? People seem to be more compliant with herbal medications and vitamins than with synthetic pharmaceuticals—but that may be because they have elected to take them.

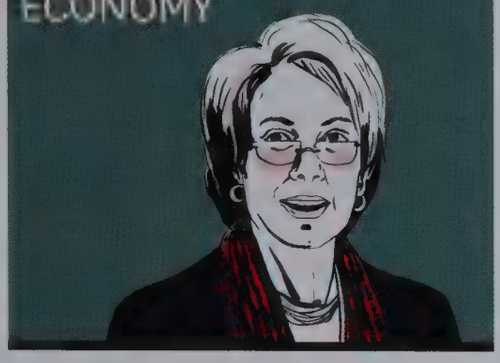
Overall, I want to understand the psychological barriers at play, because they stand in the way of solving problems we must solve. Frankly, the way we live now can't possibly be sustained with a global population of a few billion more. In order to thrive, we will most likely have to accept genetically modified foods of all sorts, and understanding the resistance to them is an important step. ■

Dan Ariely is the James B. Duke Professor of Behavioral Economics at Duke University.

INVESTMENT

LAURA D. TYSON

A BETTER STIMULUS PLAN FOR THE U.S. ECONOMY



Although stimulus spending is a politically contentious issue, America is now in urgent need of a national infrastructure bank to help finance transformative projects of national importance. During the coming year I will work with the Obama administration; Senator John Kerry, Representative Rosa DeLauro, and other members of Congress; governors; mayors; and business leaders on legislation to establish and provide the capital for such an institution. I will also foster public support for its creation through speeches, interviews, and opinion columns like this one.

Unlike most other forms of stimulus, infrastructure spending benefits the economy in two ways: First, it creates jobs—which, because those jobs put money in consumers' pockets, spurs demand. Analysis by the Congressional Budget Office indicates that infrastructure spending is a cost-effective demand stimulus as measured by the number of jobs created per dollar of budgetary expenditure.

Second, the resulting infrastructure enhancement supports supply and growth over time. By contrast, underinvestment not only hobbles U.S. competitiveness but also affects America's national security as vulnerabilities go unaddressed. In its 2009 report on the state of the nation's infrastructure, the American Society of Civil Engineers gave the U.S. a near-failing grade of D. Perhaps that should not be surprising, given that real infrastructure spending today is about the same as it was in 1968, when the economy was smaller by a third. A 2008 CBO study concluded, for example, that a 74% increase in annual spending on transportation infrastructure alone would be economically justifiable. That calculation leaves out additional infrastructure spending needed for other key public goals such as water delivery and sanitation.

Realizing the highest possible return on infrastructure investments depends on funding the projects with the biggest impact and financing them in the most advantageous way. Properly designed and governed, a national infrastructure bank would overcome weaknesses in the current selection of projects by removing funding decisions from the politically volatile appropriations process. A common complaint today is that projects are often funded on the basis of politics rather than efficiency. Investments would instead be selected after independent and transparent cost-benefit analysis by objective experts.

The bank would provide the most appropriate form of financing for each project, drawing on a flexible set of tools such as direct loans, loan guarantees, grants, and interest subsidies for Build America Bonds. It should be given the authority to form partnerships with private investors, which would increase funding for infrastructure investments and foster efficiency in project selection, operation, and maintenance. That would enable the bank to tap into the significant pools of long-term private capital in pension funds and dedicated infrastructure equity funds looking for such investment opportunities.

Crafting the law to achieve these goals is a serious and challenging undertaking, particularly in view of large budget deficits and a contentious political atmosphere. But I believe they are worthy of the political and legislative effort required to realize them. The U.S. must invest considerably more in its infrastructure to secure its competitiveness and deliver rising standards of living. This effort would also put millions of Americans to work in meaningful jobs. The time has come to make it happen. ■

Laura D. Tyson holds the Chan Chair in Global Management at UC Berkeley's Haas School of Business.

HBR.ORG Eleven additional contributors to the Agenda can be found at **hbr.org/2011-agenda**.

INNOVATION
TIM BROWN
Innovation requires risk-taking—but clients want accountability. Brown is designing arrangements to let creatives take flyers while being trusted to deliver.

CAREERS
PETER CAPPELLI
We know careers don't proceed in the lockstep fashion they used to. Let's get the fact base to understand the new patterns of executive success.

PEOPLE
CLAUDIO FERNÁNDEZ-ARÁOZ
It matters a lot who sits in positions of leadership—so why are so many senior appointments made so capriciously?

THE FUTURE OF WORK
LYNDA GRATTON
Her consortium of firms will prepare for workplace changes they see coming but lack the capabilities to deal with.

TEAMS
J. RICHARD HACKMAN
Harvard's expert on team dynamics turns his attention to a growing phenomenon: "sand dune" teams, which defy stability yet take on the weightiest of challenges.

THE SMART GRID
PAUL KEDROSKY
We can greatly heighten energy efficiency, but only if we "webify" the grid. Kedrosky will help power hackers find solutions for both storage and creation.

SOCIAL MEDIA
CHARLENE LI
Corporations have done cool things with social media, but mainly on an experimental basis. Li wants to know how they'll connect the new tools to strategy.

PERFORMANCE
JEAN-FRANÇOIS MANZONI
Bosses often unwittingly set up their subordinates to fail. Manzoni has found that the syndrome goes far beyond those relationships—and so must his work.

THE WORKPLACE
DANIEL PINK
Do companies succeed best when they marry their profit motive to a "purpose motive"?

MULTICULTURAL TEAMS
EDGAR H. SCHEIN
By studying how multicultural teams manage to work as one in high-hazard situations, Schein will find keys to capitalizing on diversity in every business.

CHANGE MANAGEMENT
ROBERT I. SUTTON
It's one thing to create an oasis of model behavior in a single hospital ward or work unit. How do we get it to scale?

MEDICINE

ESTHER DUFLO
MAKING IMMUNIZATION WORK IN POOR AREAS



In the coming year I'll be involved in an effort to promote immunization in poor areas. The goal is to bring to scale a program that Abhijit Banerjee, Rachel Glennerster, and I evaluated in collaboration with Seva Mandir, a nongovernmental organization in the Indian state of Rajasthan.

In the area of Rajasthan where we're working, the immunization rate is exceedingly low. Before our studies began, it was less than 2% for full immunization—the five shots that any child should have received by the age of one. Part of the problem lies with the government health care service, which is plagued by absenteeism. One can easily understand why a family would choose not to walk a mile or two in the hot sun to risk finding an empty immunization center. Families may also not be fully informed. But another part of the problem is demand: Precisely because immunization takes some effort—some time for the parents and some discomfort for the child—and its benefits may not be clearly understood, parents tend to procrastinate.

With Seva Mandir, we designed and evaluated two programs that allow us to see whether fixing the supply will help sufficiently and whether demand can be nudged.

To fix the supply, Seva Mandir entered into a partnership with the government. It hired nurses on motorcycles, who used government-provided vaccines to run monthly clinics in 60 randomly chosen villages. A local worker in each village was put in charge of reminding everyone when the clinic would be open and which children were due for a vaccine. The worker also educated families about the importance of immunization.

To experiment with improving demand, in half the clinics we offered mothers a kilo of lentils for each immunization. This small amount won't sway someone who has a fundamental problem with immunization, but it will nudge someone who is simply procrastinating.

Fixing supply helped: The rate of full immunization increased to 17%. But nudging demand helped even more: The rate jumped to 38%. And distributing lentils turned out to be a cost-effective way to nudge demand, because each nurse was immunizing more kids.

Our next objective is to get an entire Indian state, or possibly more, to adopt our program as policy. To that end, we hope to run an experiment in Bihar, one of India's poorest and most populous states. If the program works there, too, and within the government system, we will have created a compelling case for broader adoption—eventually throughout India. ■

Esther Duflo is the Abdul Latif Jameel Professor of Poverty Alleviation and Development Economics at MIT.

THE INTERNET

CLAY SHIRKY
CLEANING UP ONLINE CONVERSATION



In the 1990s putting up a forum that allowed anyone to say anything seemed like a good idea. It wasn't.

Here's something you might not have noticed about the internet: Some of the conversations taking place there are less than civil.

We could expand that thought: The ignorant and repulsive tantrums now appearing daily on the global stage mark an all-time low in public discourse. The reaction of many cultural critics is to say, "Behold humanity in a state of nature" and to yearn for the silence of the audience enforced by 20th century media.

But dismal online conversations aren't part of the state of nature; everything online takes place in a constructed environment. That means bad discourse isn't a behavior problem, it's a design problem. This year I'm studying how to design for better conversation.

The first step will be to examine sites that routinely achieve good interactions. Amazon is the granddaddy of pooled user feedback—the reviews its customers produce, individually and collectively, provide a huge competitive advantage. Get Satisfaction is designed to help people complain, yet they do it in a way so useful that businesses pay for the service. Stack Overflow helps programmers pool their knowledge; HowardForums does the same for mobile phone users, English Companion for teachers, Ravelry for knitters. So if the conversation on HowardForums is good and the conversation among commenters on CNN.com isn't, does that

CONTINUED ON PAGE 56



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SHIRKY CONTINUED

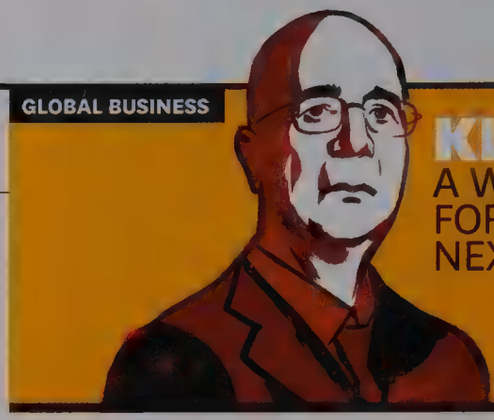
suggest a design principle beyond "Avoid politics"?

Yes, it does, if you recognize that a rhetorical tragedy of the commons is occurring in many forums. All the participants have an incentive to have good conversations, but each participant also has an incentive to get the most attention. This tension suggests that increases in individual anonymity or in group size also increase the likelihood that someone will start acting like a jerk. Both anonymity and scale reduce what Robert Axelrod calls "the shadow of the future"—the sense that our current actions will have consequences down the road.

That provides some options for turning the jerk dial down. One is to make identity valuable: Stack Overflow won't let new users post until they have exhibited enough other behaviors—visiting the site, responding in helpful ways to other posts—to earn the karma for full participation. Another approach is to partition public platforms, thus reducing the incentive to publicly act out. Twitter does this by segmenting its audience: I can rant all I like, but only to the users I can persuade to follow me. Yet another approach is to enlist users in defensive filtering. Amazon sometimes refuses to publish a post, but most of its policing is done by customers who flag offensive reviews and elevate those they find helpful.

In the 1990s, when few businesses really knew what they were doing and the online population was small, putting up a forum that allowed anyone to say anything seemed like a good idea. It wasn't. People aren't naturally well behaved; we're well behaved in environments that reward good behavior and punish bad behavior. Conversation can be incredibly valuable where it works well and terrible where it works badly. We need to structure environments to promote the former and discourage the latter; anyone who wants to get value out of convening many minds has to create and maintain the shadow of the future, or else risk activating the witlessness of crowds. ■

Clay Shirky is a consultant, a writer, and an adjunct professor in NYU's graduate Interactive Telecommunications Program.



GLOBAL BUSINESS

KLAUS SCHWAB

A WORLDWIDE NETWORK FOR RESPONDING TO THE NEXT CRISIS

In the year ahead, the World Economic Forum will embark on an ambitious undertaking: the creation of a platform to enable decision makers around the world to pool knowledge about the risks they face, to share best practices in risk management, and to respond collectively to emerging threats. This initiative, the Risk Response Network, recognizes that the world's institutions now confront greater risk exposure at all levels, that the risks are increasingly complex and interdependent, and that the context for global cooperation has evolved. The network will be committed to developing tools and processes to help it not only understand key risks but also respond to them collaboratively and mobilize quickly in times of crisis.

The WEF's well-established Global Risk Network draws on a community of experts from government, industry, civil society, and academia to produce in-depth knowledge about important risks. For this new initiative, however, the operative word is "response." A core element of the Risk Response Network will be the composition of its community: risk-focused professionals from both the private and the public sectors. The private-sector leaders will not be in the mold of the traditional chief risk officer, narrowly focused on a particular class of business-specific risks. Rather, they will be senior executives actively considering the breadth of enterprise-level risks facing their institutions. The public-sector leaders will include country risk officers, often cabinet-level government officials, and analogous representatives from major international institutions such as the World Health Organization.

The commitment of leaders at this level to learn, plan, and act jointly may constitute a fundamentally new and better approach to understanding risks and fostering resilience. Many risk management solutions center on behavior change and governance, but both of those come down to the choices of decision makers and are highly dependent on individual and political will. With a concerted effort to provide the right mix of information, incentives, and institutions, we have a better chance of seeing behavior evolve.

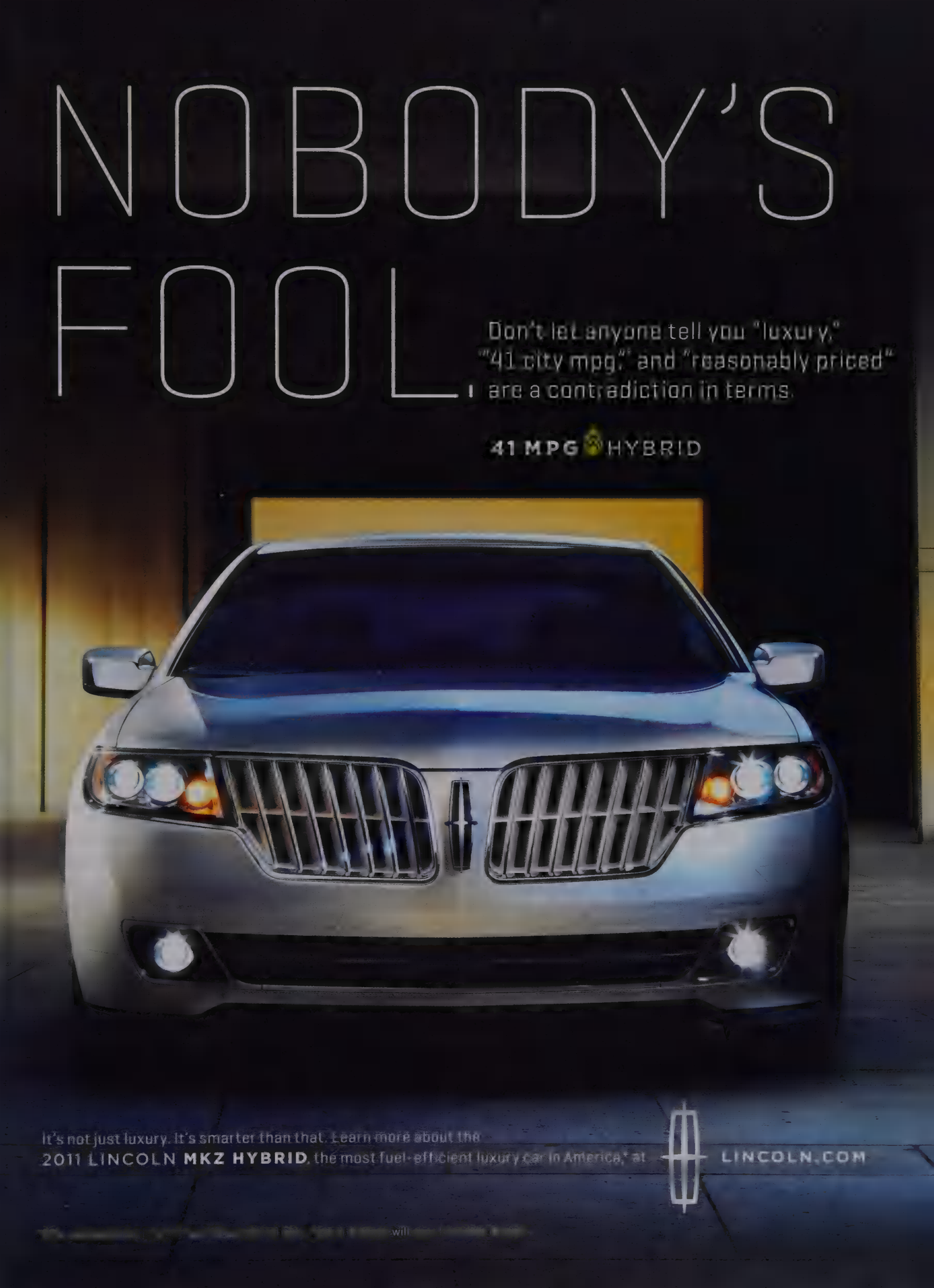
If we fail to assume collective responsibility for addressing global risks, it will be impossible to achieve much progress. Without the proper frameworks in place, market mechanisms for managing risk can't improve our aggregate global resilience. And without collaborative effort from business, government, and civil society on all these issues, our global future may be shaped more by crises than by our power to anticipate, manage, and mitigate them. ■

Klaus Schwab is the founder and executive chairman of the World Economic Forum.

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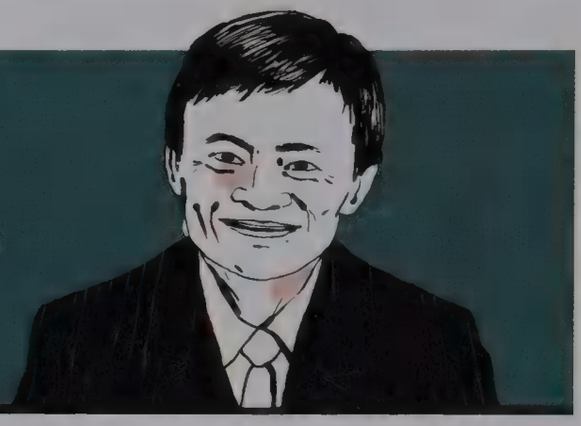


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THE ENVIRONMENT

JACK MA
INSTILLING VALUES IN A YOUTHFUL CHINESE WORKFORCE



The priority for the Alibaba Group is to continue working to instill a strong system of values in our young employee base. We have more than 19,000 employees, and their average age is 27. Having values is critical now for China. People without a sense of values can make a great deal of money, but they will have an ache in their hearts because they aren't doing things for others, for society.

I hope to push this goal beyond the Alibaba Group as well, in particular to help clean up China's environment. We've already taken several steps, focusing on clean air and trees. In May we announced that we will dedicate 0.3% of the group's revenues to these efforts. Our senior management team now meets for a full day each quarter to discuss environmental issues and projects. Employees are strongly encouraged and are given incentives to get involved, too.

A company our size has a responsibility to do the right thing. Two years ago we banned trade in shark fins on all our sites. We felt some trepidation, because shark fin is a popular dish that marks auspicious occasions for the Chinese people. But we made a commitment to protect sharks. The response from our users, who are similarly mostly young Chinese, was entirely positive and supportive.

This year we will be encouraging employees to come up with environmentally sound approaches to what we do. In some of our companies, management is devising creative ways of spurring employees to take action collectively or individually. For example, at Alibaba.com someone who demonstrates a commitment to the environment might merit a better parking space. Management's hope is that this will inspire other employees. And if we model this behavior ourselves, perhaps the many registered users on our sites will want to follow suit.

People without a sense of values can make a great deal of money, but they will have an ache in their hearts.

In China environmental change will come about only through education. One of my goals is to remind people who are skeptical about the effectiveness of clean-up efforts of what the environment was like in the United States, Europe, and Japan just a few decades ago—to show them that it's not too late for China to clean things up. ■



Jack Ma is the founder and CEO of China's Alibaba Group.

LEADERSHIP

A.G. LAFLEY
CRAFTING A RIGOROUS APPROACH TO SUCCESSION



Surveys of boards have shown a very high level of dissatisfaction with companies' succession plans. What a self-indictment: Isn't that the boards' job? Choosing a new CEO is the most important decision a board will make, yet most directors spend minimal time preparing for it and getting to know candidates on a personal level. Little wonder that companies aren't getting the leaders they need. Over the past decade turnover among *Fortune* 500 CEOs has increased significantly; the average tenure has fallen from nine years or so to about four. And companies are increasingly turning to outside "saviors" because they are dissatisfied with internal candidates. Look at Hewlett-Packard. It recently hired an outside CEO for the third time in 10 years, creating a lot of drama and controversy. The ongoing failure to develop a succession plan that includes viable internal candidates reflects poorly on HP's board and on HP's CEO.

An outside candidate may turn out to be the best choice—Lou Gerstner, for instance, is widely credited with saving IBM in the early 1990s—but the outsider shouldn't be the choice of last resort. IBM had strong internal candidates when it brought on Gerstner; when he left, the company went back inside for his successor. The board had a succession plan with options.

Boards that don't put into place a strong succession plan will continue to get the CEOs they deserve. What does such a process look like? Here are a few vital elements:

DECISION MAKING

THOMAS H. DAVENPORT

HELPING ORGANIZATIONS DEVELOP BETTER JUDGMENT



We know a little about judgment in individuals, but the imperative in the modern era is to develop judgment at the organizational level—which is not the same as the sum of individual managers' judgment. To understand how that might be done, Brook Manville, Larry Prusak, and I are studying big judgment calls that turned out well and how organizations arrived at them.

Throughout history people have marveled in retrospect at the brilliance or stupidity of major decisions. In military battles we see the shrewd strategy or cunning tactic that led to a great victory. On Wall Street we shake our heads in wonder at the trade that called an uptick or a downtick far enough in advance to make a killing. In industry we wonder at the acquisition that failed to work out or the product launch that took the world by storm. Given our traditional assumptions, we tend to assign most of the credit or blame to a leader—the general, the CEO, or the politician—and to center on questions of how astute an individual's thinking was.

The source of organizational judgment is no longer one desk where the buck stops. It is now the entire organization.

Today, however, the source of organizational judgment has fundamentally changed: No longer one desk where the buck stops, it is now the entire organization. For the past several decades we have witnessed a slow but steady evolution in the very concept of leadership, from sole heroic visionary and master delegator to a team-based and even democratic organizational model. At the same time, we recognize how many inputs judgment can have—from data-based analytics to "crowdsourced" predictions to impressionistic insights.

But if all that makes the composition of judgment more complicated, the need for good judgment is only growing. Increased interconnectedness throughout the global economy means that decisions have far-reaching consequences. More-intense competition and greater transparency mean that poorly judged moves are penalized as never before. We hope our work will lead to better judgment, by revealing how some organizations have sought the data they need without succumbing to "analysis paralysis," have democratized decision making without losing a sense of accountability, and have retained respect for the wisdom of experience without defaulting to a lazy reliance on gut feelings. ■

Thomas H. Davenport is the President's Distinguished Professor of Information Technology and Management at Babson College.

• The CEO and the lead director co-lead the process; the board is actively engaged. Succession is regularly on the agenda. It rates a full board meeting once a year and scheduled reviews throughout the year. Some boards spend as much as a third of their time on succession.

• Directors have access to candidates all the time, not just at board meetings. At P&G we asked board members to spend a couple of days each year working with candidates on their businesses, without the CEO or anyone else from corporate present. Social occasions are important, too.

Choosing a new CEO is the most important decision a board will make, yet most directors spend minimal time preparing for it and getting to know candidates.

• Planning and process are closely linked to company strategy, and they recognize business realities. Contingencies and multiple scenarios are explicit—identifying short-, medium-, and long-term needs; accounting for emergencies; anticipating potential shifts in the economy and the industry, company fortunes, and company strategies. A CEO who is suited to restructuring for a turnaround may not be the right person to lead innovation and growth. In some circumstances you need continuity and in others you need a new direction.

• Succession planning is not a periodic exercise; it never stops. When I became the chief executive officer of P&G, in 2000, we started planning for my successor in the first few months. When I retired as CEO, in June 2009, Jim McNerney and Bob McDonald began planning for Bob's successor.

• The board considers not just financial results and strategic and leadership strengths but—perhaps above all—character, integrity, and judgment.

Leadership—specifically leadership development—is vital to succession planning. That's why I'm working with boards and CEOs to craft a more rigorous process and put it into action. With Noel Tichy I also plan to write on succession for an upcoming issue of HBR. ■

A.G. Lafley is a former CEO and chairman of Procter & Gamble.

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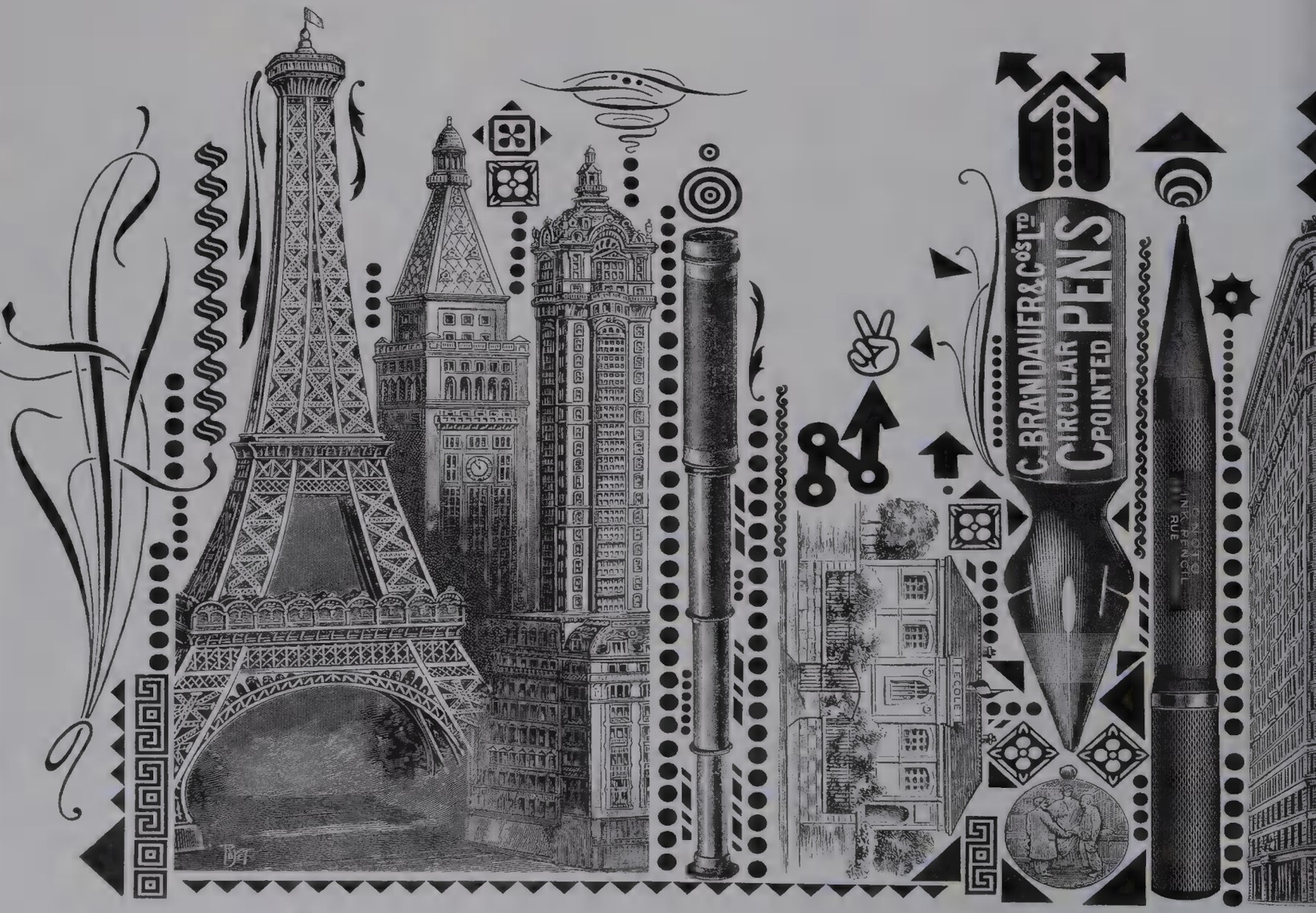


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Capitalism is under siege.... Diminished to set policies that sap economic growth... The purpose of the corporation must be

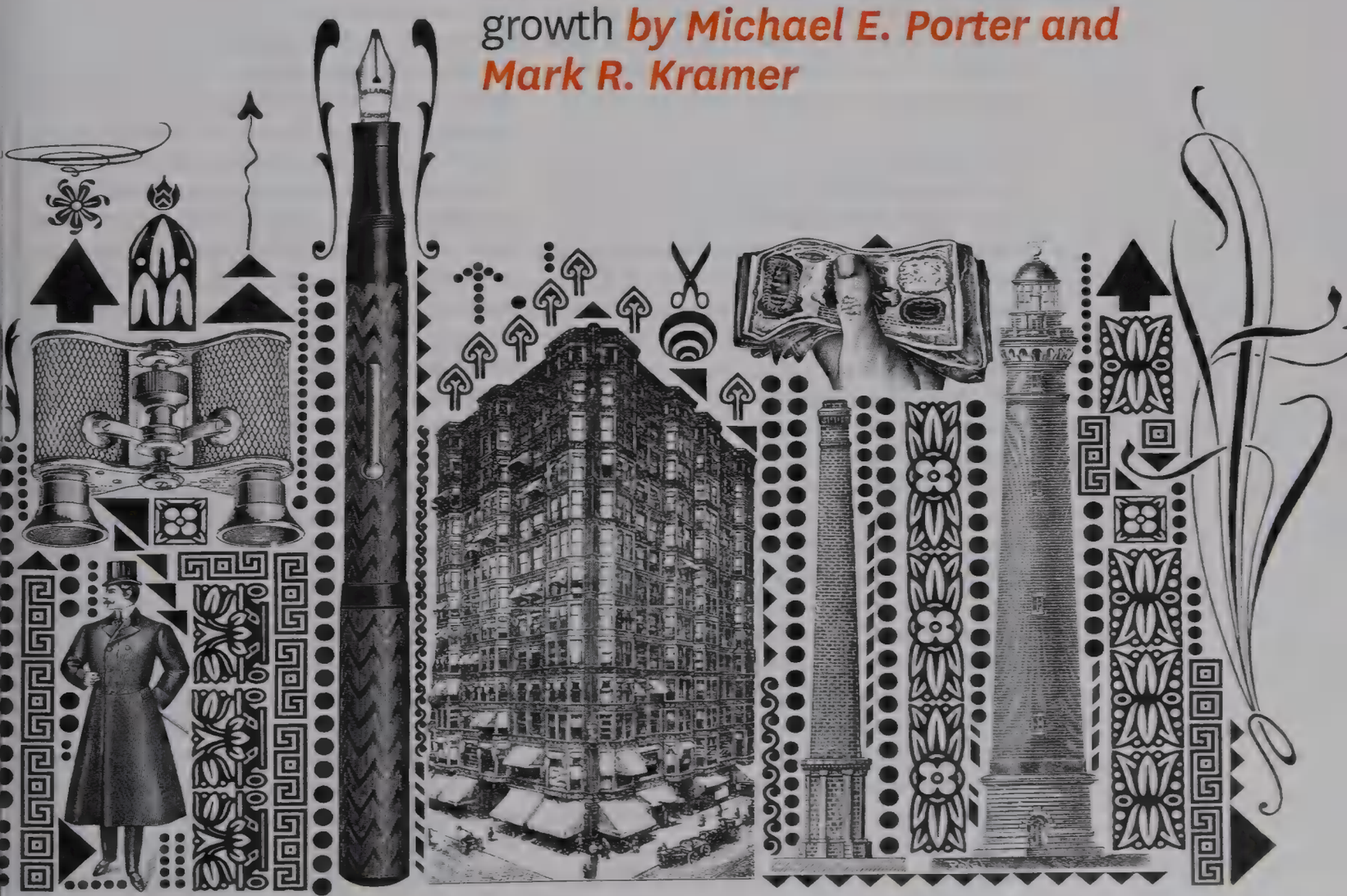
CREATING SH



trust in business is causing political leaders
Business is caught in a vicious circle....
redefined around

ARED VALUE

How to reinvent capitalism—and unleash a wave of innovation and growth *by Michael E. Porter and Mark R. Kramer*



THE CAPITALIST SYSTEM is under siege. In recent years business increasingly has been viewed as a major cause of social, environmental, and economic problems. Companies are widely perceived to be prospering at the expense of the broader community.

Even worse, the more business has begun to embrace corporate responsibility, the more it has been blamed for society's failures. The legitimacy of business has fallen to levels not seen in recent history. This diminished trust in business leads political leaders to set policies that undermine competitiveness and sap economic growth. Business is caught in a vicious circle.

A big part of the problem lies with companies themselves, which remain trapped in an outdated approach to value creation that has emerged over the past few decades. They continue to view value creation narrowly, optimizing short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success. How else could companies overlook the well-being of their customers, the depletion of natural resources vital to their businesses, the viability of key suppliers, or the economic distress of the communities in which they produce and sell? How else could companies think that simply shifting activities to locations with ever lower wages was a sustainable "solution" to competitive challenges? Government and civil society have often exacerbated the problem by attempting to address social weaknesses at the expense of business. The presumed trade-offs between economic efficiency and social progress have been institutionalized in decades of policy choices.

Companies must take the lead in bringing business and society back together. The recognition is there among sophisticated business and thought leaders, and promising elements of a new model are emerging. Yet we still lack an overall framework for guiding these efforts, and most companies remain stuck in a "social responsibility" mind-set in which societal issues are at the periphery, not the core.

The solution lies in the principle of shared value, which involves creating economic value in a way that *also* creates value for society by addressing its needs and challenges. Businesses must reconnect company success with social progress. Shared value is not social responsibility, philanthropy, or even sustainability, but a new way to achieve economic success. It is not on the margin of what companies do but at the center. We believe that it can give rise to the next major transformation of business thinking.

A growing number of companies known for their hard-nosed approach to business—such as GE, Google, IBM, Intel, Johnson & Johnson, Nestlé, Unilever, and Wal-Mart—have already embarked on important efforts to create shared value by reconceiving the intersection between society and corporate performance. Yet our recognition of the transformative power of shared value is still in its genesis. Realizing it will require leaders and managers to develop new skills and knowledge—such as a far deeper appreciation of societal needs, a greater understanding of the true bases of company productivity, and the ability to collaborate across profit/nonprofit boundaries. And government must learn how to regulate in ways that enable shared value rather than work against it.

Capitalism is an unparalleled vehicle for meeting human needs, improving efficiency, creating jobs, and building wealth. But a narrow conception of capitalism has prevented business from harnessing its full potential to meet society's broader challenges. The opportunities have been there all along but have been overlooked. Businesses acting as businesses, not as charitable donors, are the most powerful force for addressing the pressing issues we face. The moment for a new conception of capitalism is now; society's needs are large and growing, while customers, employees, and a new generation of young people are asking business to step up.

The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy. It will also reshape capitalism and its relationship to society. Perhaps most important of all, learning how to create shared value is our best chance to legitimize business again.

Moving Beyond Trade-Offs

Business and society have been pitted against each other for too long. That is in part because economists have legitimized the idea that to provide societal benefits, companies must temper their economic success. In neoclassical thinking, a requirement for social improvement—such as safety or hiring the disabled—imposes a constraint on the corporation. Adding a constraint to a firm that is already maximiz-

Idea in Brief

The concept of shared value—which focuses on the connections between societal and economic progress—has the power to unleash the next wave of global growth.

An increasing number of companies known for their hard-nosed approach to business—such as Google, IBM, Intel, Johnson & Johnson, Nestlé, Unilever, and Wal-Mart—have begun to embark on important shared value initiatives. But our understanding of the potential of shared value is just beginning.

There are three key ways that companies can create shared value opportunities:

- By reconceiving products and markets
- By redefining productivity in the value chain
- By enabling local cluster development

Every firm should look at decisions and opportunities through the lens of shared value. This will lead to new approaches that generate greater innovation and growth for companies—and also greater benefits for society.

Societal needs, not just conventional economic needs, define markets, and social harms can create internal costs for firms.

ing profits, says the theory, will inevitably raise costs and reduce those profits.

A related concept, with the same conclusion, is the notion of externalities. Externalities arise when firms create social costs that they do not have to bear, such as pollution. Thus, society must impose taxes, regulations, and penalties so that firms "internalize" these externalities—a belief influencing many government policy decisions.

This perspective has also shaped the strategies of firms themselves, which have largely excluded social and environmental considerations from their economic thinking. Firms have taken the broader context in which they do business as a given and resisted regulatory standards as invariably contrary to their interests. Solving social problems has been ceded to governments and to NGOs. Corporate responsibility programs—a reaction to external pressure—have emerged largely to improve firms' reputations and are treated as a necessary expense. Anything more is seen by many as an irresponsible use of shareholders' money. Governments, for their part, have often regulated in a way that makes shared value more difficult to achieve. Implicitly, each side has assumed that the other is an obstacle to pursuing its goals and acted accordingly.

The concept of shared value, in contrast, recognizes that societal needs, not just conventional economic needs, define markets. It also recognizes that social harms or weaknesses frequently create *internal* costs for firms—such as wasted energy or raw materials, costly accidents, and the need for remedial training to compensate for inadequacies in education. And addressing societal harms and constraints does not necessarily raise costs for firms, because they can innovate through using new technologies, operating methods, and management approaches—and as a result, increase their productivity and expand their markets.

Shared value, then, is not about personal values. Nor is it about "sharing" the value already created by firms—a redistribution approach. Instead, it is about expanding the total pool of economic and social value. A good example of this difference in perspective is the fair trade movement in purchasing. Fair trade aims to increase the proportion of revenue that goes to poor farmers by paying them higher prices for the same crops. Though this may be a noble sentiment, fair trade is mostly about redistribution rather than expanding the overall amount of value created. A shared value perspective, instead, focuses on improving growing techniques and strengthening the local cluster of supporting suppliers and other institutions in order to increase farmers' efficiency, yields, product quality, and sustainability. This leads to a bigger pie of revenue and profits that benefits both farmers and the companies that buy from them. Early studies of cocoa farmers in the Côte d'Ivoire, for instance, suggest that while fair trade can increase farmers' incomes by 10% to 20%, shared value investments can raise their incomes by more than 300%. Initial investment and time may be required to implement new procurement practices and develop the supporting cluster, but the return will be greater economic value and broader strategic benefits for all participants.

The Roots of Shared Value

At a very basic level, the competitiveness of a company and the health of the communities around it are closely intertwined. A business needs a successful community, not only to create demand for its products but also to provide critical public assets and a supportive environment. A community needs successful businesses to provide jobs and wealth creation opportunities for its citizens. This interdependence means that public policies that undermine the productivity and competitiveness of businesses are self-defeating, especially in a global economy where facilities and jobs can easily move elsewhere. NGOs and governments have not always appreciated this connection.

In the old, narrow view of capitalism, business contributes to society by making a profit, which supports employment, wages, purchases, investments, and taxes. Conducting business as usual is sufficient social benefit. A firm is largely a self-contained entity, and social or community issues fall outside its proper scope. (This is the argument advanced persuasively by Milton Friedman in his critique of the whole notion of corporate social responsibility.)

This perspective has permeated management thinking for the past two decades. Firms focused on enticing consumers to buy more and more of their products. Facing growing competition and shorter-term performance pressures from shareholders, managers resorted to waves of restructuring, personnel reductions, and relocation to lower-cost regions, while leveraging balance sheets to return capital to investors. The results were often commoditization, price competition, little true innovation, slow organic growth, and no clear competitive advantage.

In this kind of competition, the communities in which companies operate perceive little benefit even as profits rise. Instead, they perceive that profits come at their expense, an impression that has become even stronger in the current economic recovery, in which rising earnings have done little to offset high unemployment, local business distress, and severe pressures on community services.

It was not always this way. The best companies once took on a broad range of roles in meeting the needs of workers, communities, and supporting businesses. As other social institutions appeared on the scene, however, these roles fell away or were delegated. Shortening investor time horizons began to narrow thinking about appropriate investments. As the vertically integrated firm gave way to greater reliance on outside vendors, outsourcing and offshoring weakened the connection between firms and their communities. As firms moved disparate activities to more and more locations, they often lost touch with any location. Indeed, many companies no longer recognize a home—but see themselves as "global" companies.

These transformations drove major progress in economic efficiency. However, something profoundly important was lost in the process, as more-fundamental opportunities for value creation were missed. The scope of strategic thinking contracted.

Strategy theory holds that to be successful, a company must create a distinctive value proposition that meets the needs of a chosen set of customers. The firm gains competitive advantage from how it configures the value chain, or the set of activities involved in creating, producing, selling, delivering, and supporting its products or services. For decades businesspeople have studied positioning and the best ways to design activities and integrate them. However, companies have overlooked opportunities to meet fundamental societal needs and misun-

WHAT IS "SHARED VALUE"?

The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress.

The concept rests on the premise that both economic and social progress must be addressed using value principles. Value is defined as benefits relative to costs, not just benefits alone. Value creation is an idea that has long been recognized in business, where profit is revenues earned from customers minus the costs incurred. However, businesses have rarely approached societal issues from a value perspective but have treated them as peripheral matters. This has obscured the connections between economic and social concerns.

In the social sector, thinking in value terms is even less common. Social organizations and government entities often see success solely in terms of the benefits achieved or the money expended. As governments and NGOs begin to think more in value terms, their interest in collaborating with business will inevitably grow.

derstood how societal harms and weaknesses affect value chains. Our field of vision has simply been too narrow.

In understanding the business environment, managers have focused most of their attention on the industry, or the particular business in which the firm competes. This is because industry structure has a decisive impact on a firm's profitability. What has been missed, however, is the profound effect that location can have on productivity and innovation. Companies have failed to grasp the importance of the broader business environment surrounding their major operations.

How Shared Value Is Created

Companies can create economic value by creating societal value. There are three distinct ways to do this: by reconceiving products and markets, redefining productivity in the value chain, and building supportive industry clusters at the company's locations. Each of these is part of the virtuous circle of shared value; improving value in one area gives rise to opportunities in the others.

The concept of shared value resets the boundaries of capitalism. By better connecting companies' success with societal improvement, it opens up many ways to serve new needs, gain efficiency, create differentiation, and expand markets.

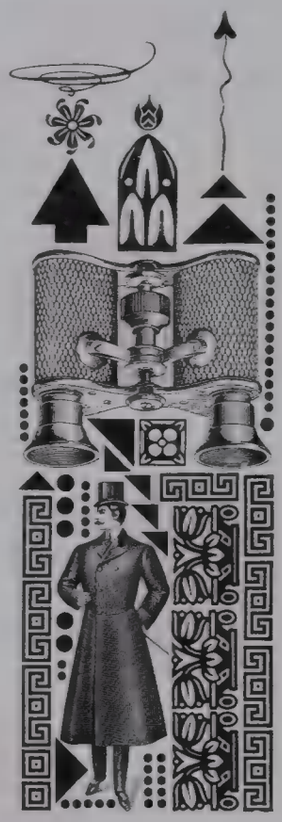
The ability to create shared value applies equally to advanced economies and developing countries, though the specific opportunities will differ. The opportunities will also differ markedly across industries and companies—but every company has them. And their range and scope is far broader than has been recognized. *[The idea of shared value was initially explored in a December 2006 HBR article by Michael E. Porter and Mark R. Kramer, "Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility."]*

Reconceiving Products and Markets

Society's needs are huge—health, better housing, improved nutrition, help for the aging, greater financial security, less environmental damage. Arguably, they are the greatest unmet needs in the global economy. In business we have spent decades learning how to parse and manufacture demand while missing the most important demand of all. Too many companies have lost sight of that most basic of questions: Is our product good for our customers? Or for our customers' customers?

In advanced economies, demand for products and services that meet societal needs is rapidly growing. Food companies that traditionally concentrated on taste and quantity to drive more and more consumption are refocusing on the fundamental need for better nutrition. Intel and IBM are both devising ways to help utilities harness digital intelligence in order to economize on power usage. Wells Fargo has developed a line of products and tools that help customers budget, manage credit, and pay down debt. Sales of GE's Ecomagination products reached $18 billion in 2009—the size of a *Fortune* 150 company. GE now predicts that revenues of Ecomagination products will grow at twice the rate of total company revenues over the next five years.

In these and many other ways, whole new avenues for innovation open up, and shared value is created. Society's gains are even greater, because businesses will often be far more effective than governments and nonprofits are at marketing that motivates customers to embrace products and services that create societal benefits, like healthier food or environmentally friendly products.



BLURRING THE PROFIT/NONPROFIT BOUNDARY

The concept of shared value blurs the line between for-profit and nonprofit organizations. New kinds of hybrid enterprises are rapidly appearing. For example, WaterHealth International, a fast-growing for-profit, uses innovative water purification techniques to distribute clean water at minimal cost to more than one million people in rural India, Ghana, and the Philippines. Its investors include not only the socially focused Acumen Fund and the International Finance Corporation of the World Bank but also Dow Chemical's venture fund. Revolution Foods, a four-year-old venture-capital-backed U.S. start-up, provides 60,000 fresh, healthful, and nutritious meals to students daily—and does so at a higher gross margin than traditional competitors. Waste Concern, a hybrid profit/nonprofit enterprise started in Bangladesh 15 years ago, has built the capacity to convert 700 tons of trash, collected daily from neighborhood slums, into organic fertilizer, thereby increasing crop yields and reducing CO_2 emissions. Seeded with capital from the Lions Club and the United Nations Development Programme, the company improves health conditions while earning a substantial gross margin through fertilizer sales and carbon credits.

The blurring of the boundary between successful for-profits and nonprofits is one of the strong signs that creating shared value is possible.

THE CONNECTION BETWEEN COMPETITIVE ADVANTAGE AND SOCIAL ISSUES

There are numerous ways in which addressing societal concerns can yield productivity benefits to a firm. Consider, for example, what happens when a firm invests in a wellness program. Society benefits because employees and their families become healthier, and the firm minimizes employee absences and lost productivity. The graphic below depicts some areas where the connections are strongest.



Equal or greater opportunities arise from serving disadvantaged communities and developing countries. Though societal needs are even more pressing there, these communities have not been recognized as viable markets. Today attention is riveted on India, China, and increasingly, Brazil, which offer firms the prospect of reaching billions of new customers at the bottom of the pyramid—a notion persuasively articulated by C.K. Prahalad. Yet these countries have always had huge needs, as do many developing countries.

Similar opportunities await in nontraditional communities in advanced countries. We have learned, for example, that poor urban areas are America's most underserved market; their substantial concentrated purchasing power has often been overlooked. (See the research of the Initiative for a Competitive Inner City, at icic.org.)

The societal benefits of providing appropriate products to lower-income and disadvantaged consumers can be profound, while the profits for companies can be substantial. For example, low-priced cell phones that provide mobile banking services are helping the poor save money securely and transforming the ability of small farmers to produce and market their crops. In Kenya, Vodafone's M-PESA mobile banking service signed up 10 million customers in three years; the funds it handles now represent 11% of that country's GDP. In India, Thomson Reuters has developed a promising monthly service for farmers who earn an average of $2,000 a year. For a fee of $5 a quarter, it provides weather and crop-pricing information and agricultural advice. The service reaches an estimated 2 million farmers, and early research indicates that it has helped increase the incomes of more than 60% of them—in some cases even tripling incomes. As capitalism begins to work in poorer communities, new opportunities for economic development and social progress increase exponentially.

For a company, the starting point for creating this kind of shared value is to identify all the societal needs, benefits, and harms that are or could be embodied in the firm's products. The opportunities are not static; they change constantly as technology evolves, economies develop, and societal priorities shift. An ongoing exploration of societal needs will lead companies to discover new opportunities for differentiation and repositioning in traditional markets, and to recognize the potential of new markets they previously overlooked.

Meeting needs in underserved markets often requires redesigned products or different distribution methods. These requirements can trigger fundamental innovations that also have application in traditional markets. Microfinance, for example, was invented to serve unmet financing needs in developing countries. Now it is growing rapidly in the United States, where it is filling an important gap that was unrecognized.

Redefining Productivity In the Value Chain

A company's value chain inevitably affects—and is affected by—numerous societal issues, such as natural resource and water use, health and safety, working conditions, and equal treatment in the workplace. Opportunities to create shared value arise because societal problems can create economic costs in the firm's value chain. Many so-called externalities actually inflict internal costs on the firm, even in the absence of regulation or resource taxes. Excess packaging of products and greenhouse gases

By reducing its packaging and cutting 100 million miles from the delivery routes of its trucks, Wal-Mart lowered carbon emissions and saved $200 million in costs.

are not just costly to the environment but costly to the business. Wal-Mart, for example, was able to address both issues by reducing its packaging and rerouting its trucks to cut 100 million miles from its delivery routes in 2009, saving $200 million even as it shipped more products. Innovation in disposing of plastic used in stores has saved millions in lower disposal costs to landfills.

The new thinking reveals that the congruence between societal progress and productivity in the value chain is far greater than traditionally believed (see the exhibit "The Connection Between Competitive Advantage and Social Issues"). The synergy increases when firms approach societal issues from a shared value perspective and invent new ways of operating to address them. So far, however, few companies have reaped the full productivity benefits in areas such as health, safety, environmental performance, and employee retention and capability.

But there are unmistakable signs of change. Efforts to minimize pollution were once thought to inevitably increase business costs—and to occur only because of regulation and taxes. Today there is a growing consensus that major improvements in environmental performance can often be achieved with better technology at nominal incremental cost and can even yield net cost savings through enhanced resource utilization, process efficiency, and quality.

In each of the areas in the exhibit, a deeper understanding of productivity and a growing awareness of the fallacy of short-term cost reductions (which often actually lower productivity or make it unsustainable) are giving rise to new approaches. The following are some of the most important ways in which shared value thinking is transforming the value chain, which are not independent but often mutually reinforcing. Efforts in these and other areas are still works in process, whose implications will be felt for years to come.

Energy use and logistics. The use of energy throughout the value chain is being reexamined, whether it be in processes, transportation, buildings, supply chains, distribution channels, or support services. Triggered by energy price spikes and a new awareness of opportunities for energy efficiency, this reexamination was under way even before carbon emissions became a global focus. The result has been striking improvements in energy utilization through better technology, recycling, cogeneration, and numerous other practices—all of which create shared value.

We are learning that shipping is expensive, not just because of energy costs and emissions but because it adds time, complexity, inventory costs, and management costs. Logistical systems are beginning to be redesigned to reduce shipping distances, streamline handling, improve vehicle routing, and the like. All of these steps create shared value. The British retailer Marks & Spencer's ambitious overhaul of its supply chain, for example, which involves steps as simple as stopping the purchase of supplies from one hemisphere to ship to another, is expected to save the retailer £175 million annually by fiscal 2016, while hugely reducing carbon emissions. In the process of reexamining logistics, thinking about outsourcing and location will also be revised (as we will discuss below).

Resource use. Heightened environmental awareness and advances in technology are catalyzing new approaches in areas such as utilization of water, raw materials, and packaging, as well as expanding recycling and reuse. The opportunities apply to all resources, not just those that have been identified by environmentalists. Better resource utilization—enabled by improving technology—will permeate all parts of the value chain and will spread to suppliers and channels. Landfills will fill more slowly.

For example, Coca-Cola has already reduced its worldwide water consumption by 9% from a 2004 baseline—nearly halfway to its goal of a 20% reduction by 2012. Dow Chemical managed to reduce consumption of fresh water at its largest production site by one billion gallons—enough water to supply nearly 40,000 people in the U.S. for a year—resulting in savings of $4 million. The demand for water-saving technology has allowed India's Jain Irrigation,

a leading global manufacturer of complete drip irrigation systems for water conservation, to achieve a 41% compound annual growth rate in revenue over the past five years.

Procurement. The traditional playbook calls for companies to commoditize and exert maximum bargaining power on suppliers to drive down prices—even when purchasing from small businesses or subsistence-level farmers. More recently, firms have been rapidly outsourcing to suppliers in lower-wage locations.

Today some companies are beginning to understand that marginalized suppliers cannot remain productive or sustain, much less improve, their quality. By increasing access to inputs, sharing technology, and providing financing, companies can improve supplier quality and productivity while ensuring access to growing volume. Improving productivity will often trump lower prices. As suppliers get stronger, their environmental impact often falls dramatically, which further improves their efficiency. Shared value is created.

A good example of such new procurement thinking can be found at Nespresso, one of Nestlé's fastest-growing divisions, which has enjoyed annual growth of 30% since 2000. Nespresso combines a sophisticated espresso machine with single-cup aluminum capsules containing ground coffees from around the world. Offering quality and convenience, Nespresso has expanded the market for premium coffee.

Obtaining a reliable supply of specialized coffees is extremely challenging, however. Most coffees are grown by small farmers in impoverished rural areas of Africa and Latin America, who are trapped in a cycle of low productivity, poor quality, and environmental degradation that limits production volume. To address these issues, Nestlé redesigned procurement. It worked intensively with its growers, providing advice on farming practices, guaranteeing bank loans, and helping secure inputs such as plant stock, pesticides, and fertilizers. Nestlé established local facilities to measure the quality of the coffee at the point of purchase, which allowed it to pay a premium for better beans directly to the growers and thus improve their incentives. Greater yield per hectare and higher production quality increased growers' incomes, and the environmental impact of farms shrank. Meanwhile, Nestlé's reliable supply of good coffee grew significantly. Shared value was created.

Embedded in the Nestlé example is a far broader insight, which is the advantage of buying from capable local suppliers. Outsourcing to other locations and countries creates transaction costs and inefficiencies that can offset lower wage and input costs. Capable local suppliers help firms avoid these costs and can reduce cycle time, increase flexibility, foster faster learning, and enable innovation. Buying local includes not only local companies but also local units of national or international companies. When firms buy locally, their suppliers can get stronger, increase their profits, hire more people, and pay better wages—all of which will benefit other businesses in the community. Shared value is created.

Distribution. Companies are beginning to reexamine distribution practices from a shared value perspective. As iTunes, Kindle, and Google Scholar (which offers texts of scholarly literature online) demonstrate, profitable new distribution models can also dramatically reduce paper and plastic usage. Similarly, microfinance has created a cost-efficient new model of distributing financial services to small businesses.

Opportunities for new distribution models can be even greater in nontraditional markets. For example, Hindustan Unilever is creating a new direct-to-home distribution system, run by underprivileged female entrepreneurs, in Indian villages of fewer than 2,000 people. Unilever provides microcredit and training and now has more than 45,000 entrepreneurs covering some 100,000 villages

THE ROLE OF SOCIAL ENTREPRENEURS

Businesses are not the only players in finding profitable solutions to social problems. A whole generation of social entrepreneurs is pioneering new product concepts that meet social needs using viable business models. Because they are not locked into narrow traditional business thinking, social entrepreneurs are often well ahead of established corporations in discovering these opportunities. Social enterprises that create shared value can scale up far more rapidly than purely social programs, which often suffer from an inability to grow and become self-sustaining.

Real social entrepreneurship should be measured by its ability to create shared value, not just social benefit.

By investing in employee wellness programs, Johnson & Johnson has saved $250 million on health care costs.

across 15 Indian states. Project Shakti, as this distribution system is called, benefits communities not only by giving women skills that often double their household income but also by reducing the spread of communicable diseases through increased access to hygiene products. This is a good example of how the unique ability of business to market to hard-to-reach consumers can benefit society by getting life-altering products into the hands of people that need them. Project Shakti now accounts for 5% of Unilever's total revenues in India and has extended the company's reach into rural areas and built its brand in media-dark regions, creating major economic value for the company.

Employee productivity. The focus on holding down wage levels, reducing benefits, and offshoring is beginning to give way to an awareness of the positive effects that a living wage, safety, wellness, training, and opportunities for advancement for employees have on productivity. Many companies, for example, traditionally sought to minimize the cost of "expensive" employee health care coverage or even eliminate health coverage altogether. Today leading companies have learned that because of lost workdays and diminished employee productivity, poor health costs them more than health benefits do. Take Johnson & Johnson. By helping employees stop smoking (a two-thirds reduction in the past 15 years) and implementing numerous other wellness programs, the company has saved $250 million on health care costs, a return of $2.71 for every dollar spent on wellness from 2002 to 2008. Moreover, Johnson & Johnson has benefited from a more present and productive workforce. If labor unions focused more on shared value, too, these kinds of employee approaches would spread even faster.

Location. Business thinking has embraced the myth that location no longer matters, because logistics are inexpensive, information flows rapidly, and markets are global. The cheaper the location, then, the better. Concern about the local communities in which a company operates has faded.

That oversimplified thinking is now being challenged, partly by the rising costs of energy and carbon emissions but also by a greater recognition of the productivity cost of highly dispersed production systems and the hidden costs of distant procurement discussed earlier. Wal-Mart, for example, is increasingly sourcing produce for its food sections from local farms near its warehouses. It has discovered that the savings on transportation costs and the ability to restock in smaller quantities more than offset the lower prices of industrial farms farther away. Nestlé is establishing smaller plants closer to its markets and stepping up efforts to maximize the use of locally available materials.

The calculus of locating activities in developing countries is also changing. Olam International, a leading cashew producer, traditionally shipped its nuts from Africa to Asia for processing at facilities staffed by productive Asian workers. But by opening local processing plants and training workers in Tanzania, Mozambique, Nigeria, and Côte d'Ivoire, Olam has cut processing and shipping costs by as much as 25%—not to mention, greatly reduced carbon emissions. In making this move, Olam also built preferred relationships with local farmers. And it has provided direct employment to 17,000 people—95% of whom are women—and indirect employment to an equal number of people, in rural areas where jobs otherwise were not available.

These trends may well lead companies to remake their value chains by moving some activities closer to home and having fewer major production locations. Until now, many companies have thought that being global meant moving production to locations with the lowest labor costs and designing their supply chains to achieve the most immediate impact on expenses. In reality, the strongest international competitors will often be those that can establish deeper roots in important communities. Companies that can embrace this new locational thinking will create shared value.

AS THESE examples illustrate, reimagining value chains from the perspective of shared value will offer significant new ways to innovate and unlock new economic value that most businesses have missed.



Enabling Local Cluster Development

No company is self-contained. The success of every company is affected by the supporting companies and infrastructure around it. Productivity and innovation are strongly influenced by "clusters," or geographic concentrations of firms, related businesses, suppliers, service providers, and logistical infrastructure in a particular field—such as IT in Silicon Valley, cut flowers in Kenya, and diamond cutting in Surat, India.

Clusters include not only businesses but institutions such as academic programs, trade associations, and standards organizations. They also draw on the broader public assets in the surrounding community, such as schools and universities, clean water, fair-competition laws, quality standards, and market transparency.

Clusters are prominent in all successful and growing regional economies and play a crucial role in driving productivity, innovation, and competitiveness. Capable local suppliers foster greater logistical efficiency and ease of collaboration, as we have discussed. Stronger local capabilities in such areas as training, transportation services, and related industries also boost productivity. Without a supporting cluster, conversely, productivity suffers.

Deficiencies in the framework conditions surrounding the cluster also create internal costs for firms. Poor public education imposes productivity and remedial-training costs. Poor transportation infrastructure drives up the costs of logistics. Gender or racial discrimination reduces the pool of capable employees. Poverty limits the demand for products and leads to environmental degradation, unhealthy workers, and high security costs. As companies have increasingly become disconnected from their communities, however, their influence in solving these problems has waned even as their costs have grown.

Firms create shared value by building clusters to improve company productivity while addressing gaps or failures in the framework conditions surrounding the cluster. Efforts to develop or attract capable suppliers, for example, enable the procurement benefits we discussed earlier. A focus on clusters and location has been all but absent in management thinking. Cluster thinking has also been

Creating Shared Value: Implications for Government and

While our focus here is primarily on companies, the principles of shared value apply equally to governments and nonprofit organizations.

Governments and NGOs will be most effective if they think in value terms—considering benefits relative to costs—and focus on the results achieved rather than the funds and effort expended. Activists have tended to approach social improvement from an ideological or absolutist perspective, as if social benefits should be pursued at any cost. Governments and NGOs often assume that trade-offs between economic and social benefits are inevitable, exacerbating these trade-offs through their approaches. For example, much environmental regulation still takes the form of command-and-control mandates and enforcement actions designed to embarrass and punish companies. Regulators would accomplish much more by focusing on measuring environmental performance and introducing standards, phase-in periods, and support for technology that would promote innovation, improve the environment, and increase competitiveness simultaneously.

The principle of shared value creation cuts across the traditional divide between the responsibilities of business and those of government or civil society. From society's perspective, it does not matter what types of organizations created the value. What matters is that benefits are delivered by those organizations—or combinations of organizations—that are best positioned to achieve the most impact for the least cost. Finding ways to boost productivity is equally valuable whether in the service of commercial or societal objectives. In short, the principle of value creation should guide the use of resources across all areas of societal concern.

Fortunately, a new type of NGO has emerged that understands the importance of productivity and value creation. Such organizations have often had a remarkable impact. One example is TechnoServe, which has partnered with both regional and global corporations to promote the development of competitive agricultural clusters in more than 30 countries. Root Capital accomplishes a similar objective by providing financing to farmers and businesses that are too large for microfinance but too small for normal bank financing. Since 2000, Root Capital has lent more than $200 million to 282 businesses,

missing in many economic development initiatives, which have failed because they involved isolated interventions and overlooked critical complementary investments.

A key aspect of cluster building in developing and developed countries alike is the formation of open and transparent markets. In inefficient or monopolized markets where workers are exploited, where suppliers do not receive fair prices, and where price transparency is lacking, productivity suffers. Enabling fair and open markets, which is often best done in conjunction with partners, can allow a company to secure reliable supplies and give suppliers better incentives for quality and efficiency while also substantially improving the incomes and purchasing power of local citizens. A positive cycle of economic and social development results.

When a firm builds clusters in its key locations, it also amplifies the connection between its success and its communities' success. A firm's growth has multiplier effects, as jobs are created in supporting industries, new companies are seeded, and demand for ancillary services rises. A company's efforts to improve framework conditions for the cluster spill over to other participants and the local economy. Workforce development initiatives, for example, increase the supply of skilled employees for many other firms as well.

At Nespresso, Nestlé also worked to build clusters, which made its new procurement practices far more effective. It set out to build agricultural, technical, financial, and logistical firms and capabilities in each coffee region, to further support efficiency and high-quality local production. Nestlé led efforts to increase access to essential agricultural inputs such as plant stock, fertilizers, and irrigation equipment; strengthen regional farmer co-ops by helping them finance shared wet-milling facilities for producing higher-quality beans; and support an extension program to advise all farmers on growing techniques. It also worked in partnership with the Rainforest Alliance, a leading international NGO, to teach farmers more-sustainable practices that make production volumes more reliable. In the process, Nestlé's productivity improved.



Civil Society

through which it has reached 400,000 farmers and artisans. It has financed the cultivation of 1.4 million acres of organic agriculture in Latin America and Africa. Root Capital regularly works with corporations, utilizing future purchase orders as collateral for its loans to farmers and helping to strengthen corporate supply chains and improve the quality of purchased inputs.

Some private foundations have begun to see the power of working with businesses to create shared value. The Bill & Melinda Gates Foundation, for example, has formed partnerships with leading global corporations to foster agricultural clusters in developing countries. The foundation carefully focuses on commodities where climate and soil conditions give a particular region a true competitive advantage. The partnerships bring in NGOs like TechnoServe and Root Capital, as well as government officials, to work on precompetitive issues that improve the cluster and upgrade the value chain for all participants. This approach recognizes that helping small farmers increase their yields will not create any lasting benefits unless there are ready buyers for their crops, other enterprises that can process the crops once they are harvested, and a local cluster that includes efficient logistical infrastructure, input availability, and the like. The active engagement of corporations is essential to mobilizing these elements.

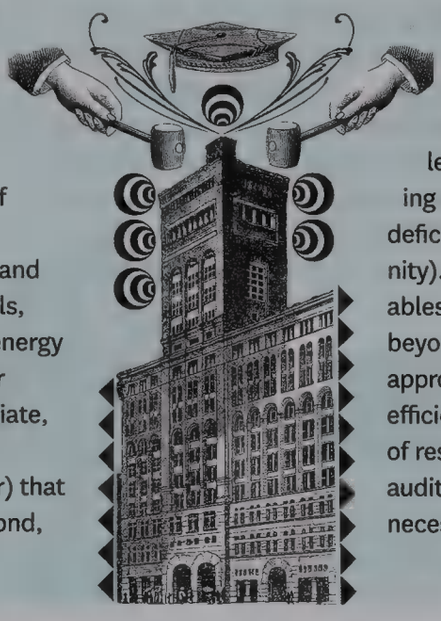
Forward-thinking foundations can also serve as honest brokers and allay fears by mitigating power imbalances between small local enterprises, NGOs, governments, and companies. Such efforts will require a new assumption that shared value can come only as a result of effective collaboration among all parties.

Government Regulation and Shared Value

The right kind of government regulation can encourage companies to pursue shared value; the wrong kind works against it and even makes trade-offs between economic and social goals inevitable.

Regulation is necessary for well-functioning markets, something that became abundantly clear during the recent financial crisis. However, the ways in which regulations are designed and implemented determine whether they benefit society or work against it.

Regulations that enhance shared value set goals and stimulate innovation. They highlight a societal objective and create a level playing field to encourage companies to invest in shared value rather than maximize short-term profit. Such regulations have a number of characteristics:



First, they set clear and measurable social goals, whether they involve energy use, health matters, or safety. Where appropriate, they set prices for resources (such as water) that reflect true costs. Second, they set performance standards but do not prescribe the methods to achieve them—those are left to companies. Third, they define phase-in periods for meeting standards, which reflect the investment or new-product cycle in the industry. Phase-in periods give companies time to develop and introduce new products and processes in a way consistent with the economics of their business. Fourth, they put in place universal measurement and performance-reporting systems, with government investing in infrastructure for collecting reliable benchmarking data (such as nutritional deficiencies in each community). This motivates and enables continual improvement beyond current targets. Finally, appropriate regulations require efficient and timely reporting of results, which can then be audited by the government as necessary, rather than impose detailed and expensive compliance processes on everyone.

Regulation that discourages shared value looks very different. It forces compliance with particular practices, rather than focusing on measurable social improvement. It mandates a particular approach to meeting a standard—blocking innovation and almost always inflicting cost on companies. When governments fall into the trap of this sort of regulation, they undermine the very progress that they seek while triggering fierce resistance from business that slows progress further and blocks shared value that would improve competitiveness.

To be sure, companies locked into the old mind-set will resist even well-constructed regulation. As shared value principles become more widely accepted, however, business and government will become more aligned on regulation in many areas. Companies will come to understand that the right kind of regulation can actually foster economic value creation.

Finally, regulation will be needed to limit the pursuit of exploitative, unfair, or deceptive practices in which companies benefit at the expense of society. Strict antitrust policy, for example, is essential to ensure that the benefits of company success flow to customers, suppliers, and workers.

A good example of a company working to improve framework conditions in its cluster is Yara, the world's largest mineral fertilizer company. Yara realized that the lack of logistical infrastructure in many parts of Africa was preventing farmers from gaining efficient access to fertilizers and other essential agricultural inputs, and from transporting their crops efficiently to market. Yara is tackling this problem through a $60 million investment in a program to improve ports and roads, which is designed to create agricultural growth corridors in Mozambique and Tanzania. The company is working on this initiative with local governments and support from the Norwegian government. In Mozambique alone, the corridor is expected to benefit more than 200,000 small farmers and create 350,000 new jobs. The improvements will help Yara grow its business but will support the whole agricultural cluster, creating huge multiplier effects.

The benefits of cluster building apply not only in emerging economies but also in advanced countries. North Carolina's Research Triangle is a notable example of public and private collaboration that has created shared value by developing clusters in such areas as information technology and life sciences. That region, which has benefited from continued investment from both the private sector and local government, has experienced huge growth in employment, incomes, and company performance, and has fared better than most during the downturn.

To support cluster development in the communities in which they operate, companies need to iden-

tify gaps and deficiencies in areas such as logistics, suppliers, distribution channels, training, market organization, and educational institutions. Then the task is to focus on the weaknesses that represent the greatest constraints to the company's own productivity and growth, and distinguish those areas that the company is best equipped to influence directly from those in which collaboration is more cost-effective. Here is where the shared value opportunities will be greatest. Initiatives that address cluster weaknesses that constrain companies will be much more effective than community-focused corporate social responsibility programs, which often have limited impact because they take on too many areas without focusing on value.

But efforts to enhance infrastructure and institutions in a region often require collective action, as the Nestlé, Yara, and Research Triangle examples show. Companies should try to enlist partners to share the cost, win support, and assemble the right skills. The most successful cluster development programs are ones that involve collaboration within the private sector, as well as trade associations, government agencies, and NGOs.

Creating Shared Value in Practice

Not all profit is equal—an idea that has been lost in the narrow, short-term focus of financial markets and in much management thinking. Profits involving a social purpose represent a higher form of capitalism—one that will enable society to advance more rapidly while allowing companies to grow even more. The result is a positive cycle of company and community prosperity, which leads to profits that endure.

Creating shared value presumes compliance with the law and ethical standards, as well as mitigating any harm caused by the business, but goes far beyond that. The opportunity to create economic value through creating societal value will be one of the most powerful forces driving growth in the global economy. This thinking represents a new way of understanding customers, productivity, and the external influences on corporate success. It highlights the immense human needs to be met, the large new markets to serve, and the internal costs of social and community deficits—as well as the competitive advantages available from addressing them. Until recently, companies have simply not approached their businesses this way.

Creating shared value will be more effective and far more sustainable than the majority of today's corporate efforts in the social arena. Companies will make real strides on the environment, for example, when they treat it as a productivity driver rather than a feel-good response to external pressure. Or consider access to housing. A shared value approach would have led financial services companies to create innovative products that prudently increased access to home ownership. This was recognized by the Mexican construction company Urbi, which pioneered a mortgage-financing "rent-to-own" plan. Major U.S. banks, in contrast, promoted unsustainable financing vehicles that turned out to be socially and economically devastating, while claiming they were socially responsible because they had charitable contribution programs.

Not all profit is equal. Profits involving a social purpose represent a higher form of capitalism, one that creates a positive cycle of company and community prosperity.

Inevitably, the most fertile opportunities for creating shared value will be closely related to a company's particular business, and in areas most important to the business. Here a company can benefit the most economically and hence sustain its commitment over time. Here is also where a company brings the most resources to bear, and where its scale and market presence equip it to have a meaningful impact on a societal problem.

Ironically, many of the shared value pioneers have been those with more-limited resources—social entrepreneurs and companies in developing countries. These outsiders have been able to see the opportunities more clearly. In the process, the distinction between for-profits and nonprofits is blurring.

Shared value is defining a whole new set of best practices that all companies must embrace. It will also become an integral part of strategy. The essence of strategy is choosing a unique positioning and a

distinctive value chain to deliver on it. Shared value opens up many new needs to meet, new products to offer, new customers to serve, and new ways to configure the value chain. And the competitive advantages that arise from creating shared value will often be more sustainable than conventional cost and quality improvements. The cycle of imitation and zero-sum competition can be broken.

The opportunities to create shared value are widespread and growing. Not every company will have them in every area, but our experience has been that companies discover more and more opportunities over time as their line operating units grasp this concept. It has taken a decade, but GE's Ecomagination initiative, for example, is now producing a stream of fast-growing products and services across the company.

A shared value lens can be applied to every major company decision. Could our product design incorporate greater social benefits? Are we serving all the communities that would benefit from our products? Do our processes and logistical approaches maximize efficiencies in energy and water use? Could our new plant be constructed in a way that achieves greater community impact? How are gaps in our cluster holding back our efficiency and speed of innovation? How could we enhance our community as a business location? If sites are comparable economically, at which one will the local community benefit the most? If a company can improve societal conditions, it will often improve business conditions and thereby trigger positive feedback loops.

The three avenues for creating shared value are mutually reinforcing. Enhancing the cluster, for example, will enable more local procurement and less dispersed supply chains. New products and services that meet social needs or serve overlooked markets will require new value chain choices in areas such as production, marketing, and distribution. And new value chain configurations will create demand for equipment and technology that save energy, conserve resources, and support employees.

Creating shared value will require concrete and tailored metrics for each business unit in each of the three areas. While some companies have begun to track various social impacts, few have yet tied them to their economic interests at the business level.

Shared value creation will involve new and heightened forms of collaboration. While some shared value opportunities are possible for a company to seize on its own, others will benefit from insights, skills, and resources that cut across profit/nonprofit and private/public boundaries. Here, companies will be less successful if they attempt to tackle societal problems on their own, especially those involving cluster development. Major competitors may also need to work together on precompetitive framework conditions, something that has not been common in reputation-driven CSR initiatives. Successful collaboration will be data driven, clearly linked to defined outcomes, well connected to the goals of all stakeholders, and tracked with clear metrics.

Governments and NGOs can enable and reinforce shared value or work against it. (For more on this

HOW SHARED VALUE DIFFERS FROM CORPORATE SOCIAL RESPONSIBILITY

Creating shared value (CSV) should supersede corporate social responsibility (CSR) in guiding the investments of companies in their communities. CSR programs focus mostly on reputation and have only a limited connection to the business, making them hard to justify and maintain over the long run. In contrast, CSV is integral to a company's profitability and competitive position. It leverages the unique resources and expertise of the company to create economic value by creating social value.

CSR	CSV
Value: doing good	Value: economic and societal benefits relative to cost
Citizenship, philanthropy, sustainability	Joint company and community value creation
Discretionary or in response to external pressure	Integral to competing
Separate from profit maximization	Integral to profit maximization
Agenda is determined by external reporting and personal preferences	Agenda is company specific and internally generated
Impact limited by corporate footprint and CSR budget	Realigns the entire company budget
Example: Fair trade purchasing	Example: Transforming procurement to increase quality and yield

In both cases, compliance with laws and ethical standards and reducing harm from corporate activities are assumed.

topic, see the sidebar "Government Regulation and Shared Value.")

The Next Evolution in Capitalism

Shared value holds the key to unlocking the next wave of business innovation and growth. It will also reconnect company success and community success in ways that have been lost in an age of narrow management approaches, short-term thinking, and deepening divides among society's institutions.

Shared value focuses companies on the right kind of profits—profits that create societal benefits rather than diminish them. Capital markets will undoubtedly continue to pressure companies to generate short-term profits, and some companies will surely continue to reap profits at the expense of societal needs. But such profits will often prove to be short-lived, and far greater opportunities will be missed.

The moment for an expanded view of value creation has come. A host of factors, such as the growing social awareness of employees and citizens and the increased scarcity of natural resources, will drive unprecedented opportunities to create shared value.

We need a more sophisticated form of capitalism, one imbued with a social purpose. But that purpose should arise not out of charity but out of a deeper understanding of competition and economic value creation. This next evolution in the capitalist model recognizes new and better ways to develop products, serve markets, and build productive enterprises.

Creating shared value represents a broader conception of Adam Smith's invisible hand. It opens the doors of the pin factory to a wider set of influences. It is not philanthropy but self-interested behavior to create economic value by creating societal value. If all companies individually pursued shared value connected to their particular businesses, society's overall interests would be served. And companies would acquire legitimacy in the eyes of the communities in which they operated, which would allow democracy to work as governments set policies that fostered and supported business. Survival of the fittest would still prevail, but market competition would benefit society in ways we have lost.

Creating shared value represents a new approach to managing that cuts across disciplines. Because of the traditional divide between economic concerns and social ones, people in the public and private sectors have often followed very different educational and career paths. As a result, few managers have the understanding of social and environmental issues required to move beyond today's CSR approaches, and few social sector leaders have the managerial training and entrepreneurial mind-set needed to design and implement shared value models. Most business schools still teach the narrow view of capitalism, even though more and more of their graduates hunger for a greater sense of purpose and a growing number are drawn to social entrepreneurship. The results have been missed opportunity and public cynicism.

Business school curricula will need to broaden in a number of areas. For example, the efficient use and stewardship of all forms of resources will define the next-generation thinking on value chains. Customer behavior and marketing courses will have to move beyond persuasion and demand creation to the study of deeper human needs and how to serve nontraditional customer groups. Clusters, and the broader locational influences on company productivity and innovation, will form a new core discipline in business schools; economic development will no longer be left only to public policy and economics departments. Business and government courses will examine the economic impact of societal factors on enterprises, moving beyond the effects of regulation and macroeconomics. And finance will need to rethink how capital markets can actually support true value creation in companies—their fundamental purpose—not just benefit financial market participants.

There is nothing soft about the concept of shared value. These proposed changes in business school curricula are not qualitative and do not depart from economic value creation. Instead, they represent the next stage in our understanding of markets, competition, and business management.

NOT ALL societal problems can be solved through shared value solutions. But shared value offers corporations the opportunity to utilize their skills, resources, and management capability to lead social progress in ways that even the best-intentioned governmental and social sector organizations can rarely match. In the process, businesses can earn the respect of society again.

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Many companies today feel pressure to change how they do business—but reinvention is more complicated than it looks.



ARTWORK Damián Ortega
Auto Construction #1, engine, 2005
set of real-concrete parts

Spotlight



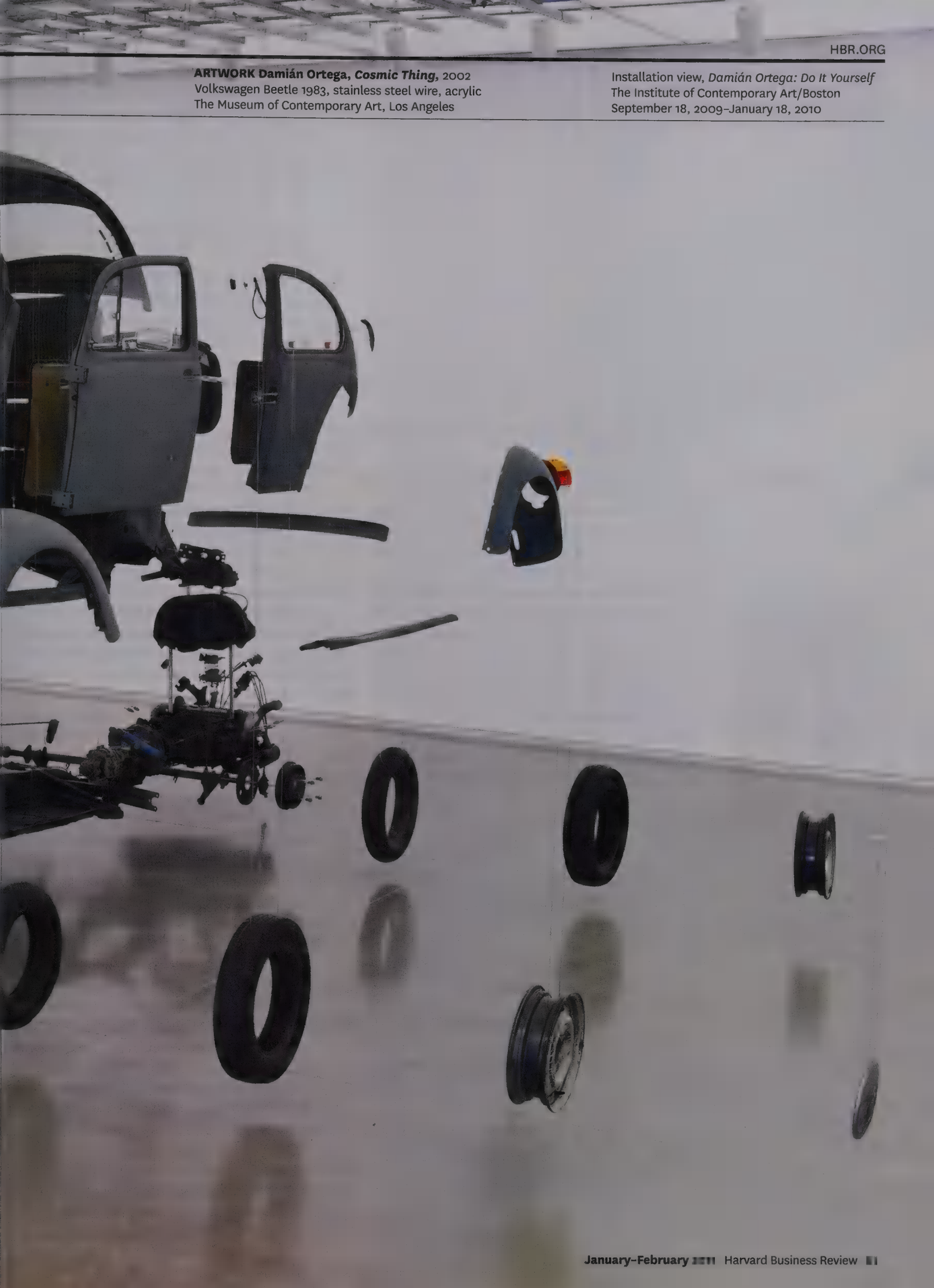
Reinvent Your Business Before It's Too Late

Watch Out for Those S Curves

by Paul Nunes and Tim Breene

ARTWORK Damián Ortega, *Cosmic Thing*, 2002
Volkswagen Beetle 1983, stainless steel wire, acrylic
The Museum of Contemporary Art, Los Angeles

Installation view, *Damián Ortega: Do It Yourself*
The Institute of Contemporary Art/Boston
September 18, 2009–January 18, 2010

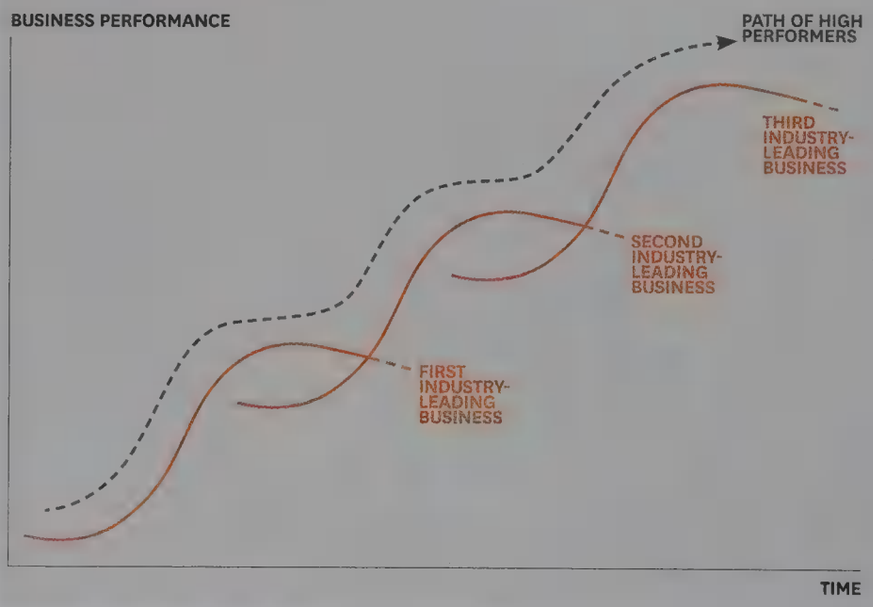


SOONER OR LATER, all businesses, even the most successful, run out of room to grow. Faced with this unpleasant reality, they are compelled to reinvent themselves periodically. The ability to pull off this difficult feat—to jump from the maturity stage of one business to the growth stage of the next—is what separates high performers from those whose time at the top is all too brief.

The potential consequences are dire for any organization that fails to reinvent itself in time. As Matthew S. Olson and Derek van Bever demonstrate in their book *Stall Points*, once a company runs up against a major stall in its growth, it has less than a 10% chance of ever fully recovering. Those odds are certainly daunting, and they do much to explain why two-thirds of stalled companies are later acquired, taken private, or forced into bankruptcy.

There's no shortage of explanations for this stalling—from failure to stick with the core (or sticking with it for too long) to problems with execution, misreading of consumer tastes, or an unhealthy focus on scale for scale's sake. What those theories have in common is the notion that stalling results from a failure to fix what is clearly broken in a company.

JUMPING THE S CURVE
High performers are well on their way to new-business success by the time their existing businesses start to stall.



Having spent the better part of a decade researching the nature of high performance in business, we realized that those explanations missed something crucial. Companies fail to reinvent themselves not necessarily because they are bad at fixing what's broken, but because they wait much too long before repairing the deteriorating bulwarks of the company. That is, they invest most of their energy managing to the contours of their existing operations—the financial S curve in which sales of a successful new offering build slowly, then ascend rapidly, and finally taper off—and not nearly enough energy creating the foundations of successful new businesses. Because of that, they are left scrambling when their core markets begin to stagnate.

In our research, we've found that the companies that successfully reinvent themselves have one trait in common. They tend to broaden their focus beyond the financial S curve and manage to three much shorter but vitally important hidden S curves—tracking the basis of competition in their industry, renewing their capabilities, and nurturing a ready supply of talent. In essence, they turn conventional wisdom on its head and learn to focus on fixing what doesn't yet appear to be broken.

Thrown a Curve

Making a commitment to reinvention before the need is glaringly obvious doesn't come naturally. Things often look rosiest just before a company heads into decline: Revenues from the current business model are surging, profits are robust, and the company stock commands a hefty premium. But that's exactly when managers need to take action.

To position themselves to jump to the next business S curve, they need to focus on the following.

The hidden competition curve. Long before a successful business hits its revenue peak, the basis of competition on which it was founded expires. Competition in the cell phone industry, for instance, has changed several times—for both manufacturers and service providers—from price to network coverage to the value of services to design, branding, and applications. The first hidden S curve tracks how competition in an industry is shifting. High performers see changes in customer needs and create the next

Idea in Brief

High performance companies rethink their strategies and reinvent their operating models before debilitating stalls set in.

In order to successfully jump from one financial S curve to the next, they do three things differently from their less-successful peers:

Focus on the edges. They pay attention to the edge of the company and the edge of the market, to avoid the myopia that long-running success engenders.

Shake up the top team. They change the makeup of the senior team earlier, and more radically, than their competitors do.

Maintain surplus talent. When other companies are cutting staff to cut costs, they go in the opposite direction: They cultivate serious talent with the capacity to grow new businesses.

High performance companies need up-and-comers who can grow a new business, not just manage an old one.

basis of competition in their industry, even as they exploit existing businesses that have not yet peaked.

Netflix, for example, radically altered the basis of competition in DVD rentals by introducing a business model that used delivery by mail. At the same time, it almost immediately set out to reinvent itself by capturing the technology that would replace physical copies of films—digital streaming over the internet. Today Netflix is the largest provider of DVDs by mail and a major player in online streaming. In contrast, Blockbuster rode its successful superstore model all the way to the top, tweaking it along the way (no more late fees) but failing to respond quickly enough to changes in the basis of competition.

The hidden capabilities curve. In building the offerings that enable them to climb the financial S curve, high performers invariably create distinctive capabilities. Prominent examples include Dell with its direct model of PC sales, Wal-Mart with its unique supply chain capabilities, and Toyota with not just its production method but also its engineering capabilities, which made possible Lexus's luxury cars and the Prius. But distinctiveness in capabilities—like the basis of competition—is fleeting, so executives must invest in developing new ones in order to jump to the next capabilities S curve. All too often, though, the end of the capabilities curve does not become apparent to executives until time to develop a new one has run out.

Take the music industry. The major players concentrated on refining current operations; it was a PC maker that developed the capabilities needed to deliver digital music to millions of consumers at an acceptable price. High performers are continually looking for ways to reinvent themselves and their market. P&G long ago recognized the untapped customer market for disposable diapers. The company spent five years perfecting the capabilities that would allow diapers to be priced similarly to what customers were then paying services to launder and deliver cloth diapers. Amazon.com CEO Jeff Bezos notes that it takes five to seven years before the seeds his company plants—things like expanding beyond media products, working with third-party sellers, and going international—grow enough to have a meaningful impact on the economics of the business; this process requires foresight, early commitment, and tenacious faith in the power of R&D.

The hidden talent curve. Companies often lose focus on developing and retaining enough of what we call serious talent—people with both the capabilities and the will to drive new business growth. This is especially true when the business is successfully humming along but has not yet peaked. In such circumstances, companies feel that operations can be leaner (they've moved far down the learning curve by then) and meaner, because they're under pressures to boost margins. They reduce both head count and investments in talent, which has the perverse effect of driving away the very people they could rely on to help them reinvent the business.

The high performers in our study maintain a steady commitment to talent creation. The oil-field services provider Schlumberger is always searching



About the Spotlight Artist

Each month we illustrate our Spotlight package with a series of works from an accomplished artist. We hope that the lively and cerebral creations of these photographers, painters, and installation artists will infuse the pages with additional energy and intelligence to amplify what are often complex and abstract concepts.

This month the Spotlight artist is Damián Ortega, whose works, as he puts it, subject everyday objects to a "mischievous process of transformation and dysfunction."

View more of the artist's work at **whitecube.com/artists/ortega/**.

for and developing serious talent, assigning "ambassadors" to dozens of top engineering schools around the world. These ambassadors include high-level executives who manage large budgets and can approve equipment donations and research funding at those universities. Close ties with the schools help Schlumberger get preference when it is recruiting. Not only does Schlumberger keep its talent pipeline flowing, but it's a leader in employee development. In fact, it is a net producer of talent for its industry, a hallmark of high performers.

By managing to these hidden curves—as well as keeping focused on the revenue growth S curve, it must be emphasized—the high performers in our study had typically started the reinvention process well before their current businesses had begun to slow. So what are the management practices that prepare high performers for reinvention? Let's look first at the response to the hidden competition curve.

Edge-Centric Strategy

Traditional strategic-planning methods are useful in stretching the revenue S curve of an existing business, but they can't help companies detect how the basis for competition in a market will change.

To make reinvention possible, companies must supplement their traditional approaches with a parallel strategy process that brings the edges of the market and the edges of the organization to the center. In this "edge-centric" approach, strategy making becomes a permanent activity without permanent structures or processes.

Moving the edge of the market to the center. An edge-centric strategy allows companies to continually scan the periphery of the market for untapped customer needs or unsolved problems. Consider how Novo Nordisk gets to the edge of the market to detect changes in the basis of competition as they're occurring. For example, through one critical initiative the pharma giant came to understand that its future businesses would have to address much more than physical health. The initiative—Diabetes Attitudes, Wishes, and Needs (DAWN)—brings together thousands of primary care physicians, nurses, medical specialists, patients, and delegates from major associations like the World Health Organization to put the individual—rather than the disease—at the center of diabetes care.

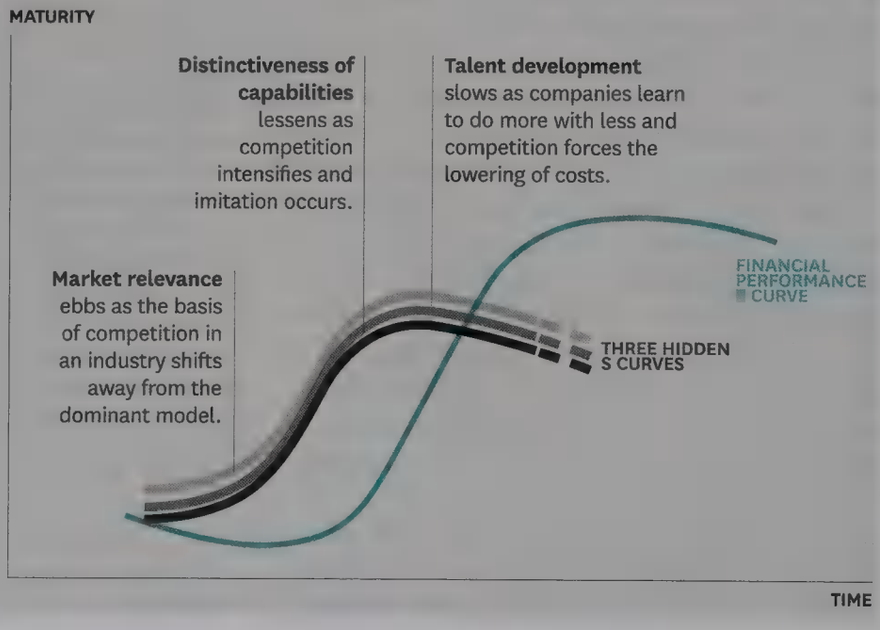
Research conducted through DAWN has opened Novo's eyes to the psychological and sociological needs of patients. For example, the company learned that more than 40% of people with diabetes also have psychological issues, and about 15% suffer from depression. Because of such insights, the company has begun to reinvent itself early; it focuses less on drug development and manufacturing and more on disease prevention and treatment, betting that the future of the company lies in concentrating on the person as well as the disease.

Moving the edge of the organization to the center. Frontline employees, far-flung research teams, line managers—all these individuals have a vital role to play in detecting important shifts in the market. High performers find ways to bring these voices into the strategy-making process. Best Buy listens to store managers far from corporate headquarters, such as the New York City manager who created a magnet store for Portuguese visitors coming off cruise ships. Reckitt Benckiser got one of its most successful product ideas, Air Wick Freshmatic, from a brand manager in Korea. The idea was initially met with considerable internal skepticism because it would require the company to incorporate electronics for the first time—but CEO Bart Becht is more impressed by passion than by consensus.

If strategy making is to remain on the edge, it cannot be formalized. We found that although low and average performers tend to make strategy according to the calendar, high performers use many methods and keep the timing dynamic to avoid predictability and to prevent the system from being gamed.

THE HIDDEN S CURVES OF HIGH PERFORMANCE

Three aspects of a business mature—and start to decline—much faster than financial performance does. They need to be reinvented before you can grow a new business.



As quickly as competition shifts, the distinctiveness of capabilities may evaporate even faster. By the time a business really takes off, imitators have usually had time to plan and begin their attack, and others, attracted to marketplace success, are sure to follow. How, then, do companies build the capabilities necessary to jump to a new financial S curve?

Change at the Top

Some executives excel at running a business—ramping up manufacturing, expanding into different geographies, or extending a product line. Others are entrepreneurial—their strength is in creating new markets. Neither is inherently better; what matters is that the capabilities of the top team match the firm's organizational needs on the capabilities S curve. Companies run into trouble when their top teams stay in place to manage the financial S curve rather than evolve to build the next set of distinctive capabilities.

Avoiding that trap runs counter to human nature, of course. What member of a top team wants to leave when business is good? High performers recognize that a key to building the capabilities necessary to jump to a new financial S curve is the early injection of new leadership blood and a continual shake-up of the top team.

Early top-team renewal. Consider how the top team at Intel has evolved. Throughout its history, the semiconductor manufacturer has seen its CEO mantle rest on five executives: Robert Noyce, Gordon Moore, Andy Grove, Craig Barrett, and current CEO Paul Otellini. Not once has the company had to look outside to find this talent, and the transitions have typically been orderly and well orchestrated. "We discuss executive changes 10 years out to identify gaps," explains David Yoffie, who has served on the Intel board since 1989.

Simple continuity is not Intel's goal in making changes at the top, however; evolving the business is. For instance, when Grove stepped down from the top spot, in 1998, he was still a highly effective leader. If continuity had been Intel's overwhelming concern, Grove might have stayed for another three years, until he reached the mandatory retirement age of 65. But instead, he handed the baton to Barrett, who then implemented a strategy for growing Intel's business through product extensions.

Indeed, each of Intel's CEOs has left his mark in a different way. Grove made the bold decision to move Intel away from memory chips in order to focus on microprocessors, a transition that established the company as a global high-tech leader. Since he took the helm, in 2005, Otellini has focused on the Atom mobile chip, which is being developed for use in just about any device that might need to connect to the web, including cell phones, navigation systems, and even sewing machines (for downloading patterns).

Through structured succession planning, Intel ensures that it chooses the CEO who is right for the challenges the company is facing, not simply the person next in line. And by changing CEOs early, the company gives its new leadership time to produce the reinvention needed, well before deteriorating revenues and dwindling options become a crisis.

Balance short-term and long-term thinking. Ensuring that the team is balanced with a focus on both the present and the future is another critical step in developing a new capabilities curve. When Adobe bought Macromedia in 2005, then-CEO Bruce Chizen took a hard look at his senior managers to determine which of them had what it took to grow the company to annual revenues of $10 billion. What he found was a number of executives who lacked either the skills or the motivation to do what was necessary.

Jumping the S curve requires frequent injections of new blood and a continual shake-up of the top team.

About the Research

At Accenture, we have been conducting the High Performance Business research program since 2003. Starting from the premise that all performance is relative, we examined sets of peer companies. Previous research on high performance had compared companies head-to-head across industries, but that approach ignored the differences in average profitability, maturity, and risk from one industry to another, making it a contest among industries rather than among companies.

We settled on 31 peer sets for our initial study, encompassing more than 800 companies and representing more than 80% of the market capitalization of the Russell 3000 Index at the time. We analyzed performance in terms of 13 financial metrics to assess growth, profitability, consistency, longevity, and positioning for the future. In most cases, we applied the metrics over a 10-year span.

The businesses that performed extraordinarily well over the long term had all made regular transitions from maturing markets to new, vibrant ones. To find out how these organizations were able to maintain a high level of performance, we conducted years of follow-on investigation, creating special teams from our industry and business-function practice areas. Team members' expertise and experience was supplemented by contributions from independent researchers and scholars.

Today, the program includes regional and global studies of high performance, to take into account the explosive success of many emerging-market companies.



Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

Consequently, Chizen tapped more executives from Macromedia than from Adobe for key roles in the new organization. Those choices were based on Adobe's future needs, not on which executives were the most capable at the time.

Chizen wasn't tough-minded just with others. At the relatively young age of 52, and only seven years into his successful tenure, he handed over the reins to Shantanu Narayen, his longtime deputy. The timing might have seemed odd, but it made good sense for Adobe: The company faced a new set of challenges—and the need for new capabilities—as it anticipated going head-to-head against larger competitors like Microsoft.

> One sign that a company is investing enough in talent: Employees have time to think on the job.

In other cases, the executive team might need to gather fresh viewpoints from within the organization to balance long-established management thinking. Before Ratan Tata took over at India's Tata Group, in 1991, executives had comfortably ruled their fiefdoms for ages and rarely retired. But the new chairman began easing out those complacent executives (not surprisingly, some of their departures were acrimonious) and instituted a compulsory retirement age to help prevent the future stagnation of his senior leadership. The dramatic change opened dozens of opportunities for rising in-house talent who have helped Tata become India's largest private corporate group.

Organize to avoid overload. Finally, high performers organize their top teams so that responsibilities are more effectively divided and conquered. Three critical tasks of senior leadership are information sharing, consulting on important decisions, and making those decisions. Although many companies have one group that performs all three functions, this can easily become unwieldy.

An alternative approach, which we observed in many high performers, is to split those tasks—in effect, creating teams nested within teams. At the very top are the primary decision makers—a group of perhaps three to seven people. This group then receives advice from other teams, so hundreds of people may be providing important input.

Surplus Talent

Business reinvention requires not just nimble top teams but also large numbers of people ready to take on the considerable challenge of getting new businesses off the ground and making them thrive. High performers take an approach that is, in its way, as difficult as changing out top leadership before the company's main business has crested: They create much more talent than they need to run the current business effectively—particularly talent of the kind that can start and grow a business, not just manage one. This can be a hard sell in the best of times, which is probably why so many avoid it.

One of the signs that a company has surplus talent is that employees have time to think on the job. Many of our high performers make time to explore a regular component of their employees' workweek. (Think Google and 3M.) Another is a deep bench—one that allows promising managers to take on developmental assignments and not just get plugged in where there is an urgent need. High performance companies aggressively search out the right type of candidate and then take action to strengthen individuals for the challenges ahead.

Hire for cultural fit. High performance companies begin with the expectation that they are hiring people for the long term—a perspective that fundamentally alters the nature of their hiring and development practices. They don't just look for the best people for the current openings; they recognize that cultural fit is what helps ensure that someone will perform exceptionally well over time.

One company that gets this right is the Four Seasons Hotels and Resorts. It specifically looks for people who will thrive in a business that treats customers like kings—because, quite literally, some guests could be. "I can teach anyone to be a waiter," says Isadore Sharp, CEO of the luxury hotel chain in his book *Four Seasons: The Story of a Business Philosophy.* "But you can't change an ingrained poor attitude. We look for people who say, 'I'd be proud to be a doorman.'"

Reckitt Benckiser also puts cultural fit at the top of its hiring priorities. Before candidates begin the application process, they can complete an online simulation that determines whether they are likely to be a good match with the firm's exceptionally driven culture. The candidates are presented with busi-

ness scenarios and asked how they would respond. After reviewing their "fit" score, they can decide for themselves whether they want to continue pursuing employment with the company.

Prepare for challenges ahead. Making sure that new employees are fit to successfully navigate the tough stretches in a long career requires something we call stressing for strength. At low-performer companies, employees may find themselves wilting when faced with unexpected or harsh terrain. High performers create environments—often challenging ones—in which employees acquire the skills and experience they will need to start the company's next S curve. The goal is partly to create what our Accenture colleague Bob Thomas, in his book on the topic, calls "crucible" experiences. These are life-changing events, whether on the job or not, whose lessons help transform someone into a leader.

Crucible experiences can—and should—be created intentionally. When Jeff Immelt was still in his early 30s and relatively new in his career at GE, he was tapped by then-CEO Jack Welch and HR chief Bill Conaty to deal with the problem of millions of faulty refrigerator compressors—despite his lack of familiarity with appliances or recalls. Immelt later said he would never have become CEO without that trial-by-fire experience.

Give employees room to grow. After choosing and testing the right employees, companies must give them a chance to develop. To truly enable them to excel in their work, companies should take a hard look at exactly what people are required to do day by day.

UPS has long known that its truck drivers are crucial to its success. Experienced drivers know the fastest routes, taking into account the time of day, the weather, and various other factors. But the turnover rate for drivers was high, partly because of the hard physical labor required to load packages onto the trucks. So UPS separated out that task and gave it to part-time workers, who were more affordable and easier to find, allowing a valuable group of employees to concentrate on their capabilities and excel at their jobs.

Companies can also use organizational structure to provide employees with ample opportunities to grow. Illinois Tool Works, a global manufacturer of industrial products and equipment, is organized into more than 800 business units. Whenever one of those units becomes too large (the maximum size is around $50 million in sales), ITW splits that business, thus opening up managerial positions for young talent. In fact, it's not uncommon for ITW managers to start running a business while they're still in their 20s.

And high performance businesses aren't afraid to leapfrog talented employees over those with longer tenure. After A.G. Lafley took over at P&G, for example, he needed someone to run the North American baby-care division, which was struggling. Instead of choosing one of the 78 general managers with seniority, he reached lower in the organization and tapped Deborah Henretta. Lafley's move paid off. Henretta reversed 20 years' worth of losses in the division and was later promoted to group president of Asia, overseeing a $4 billion-plus operation.

Breaking the mold in one way or another—as leaders have done at UPS, ITW, and P&G—is critical to building surplus talent in the organization. It not only keeps key individuals (or groups, in the case of UPS's drivers) on board; it also signals to the organization as a whole that no compromises on talent will be made in order to achieve short-sighted cost savings.

EVEN TOP organizations are vulnerable to slowdowns. In fact, an economic downturn can exacerbate problems for companies already nearing the end of their financial S curve. (See the sidebar "Why Now?") Even in the best of times, business crises—whether they are caused by hungry new competitors, transformational technology, or simply the aging of an industry or a company—come with regularity. Companies in other industries may be feeling great, while your business (or industry) faces its own great depression.

In the face of all these challenges, companies that manage themselves according to the three hidden S curves—the basis of competition, the distinctiveness of their capabilities, and a ready supply of talent—will be in a much better position to reinvent themselves, jumping to the next S curve with relative ease. Those that do not are likely to respond to a stall in growth by creating an urgent and drastic reinvention program—with little likelihood of success.

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Why Now?

Why do economic slowdowns call for innovation and reinvention?

Reduced sales and increased discounting tend to squash companies' revenue S curves. Worse, the S curves do not stretch back out as conditions improve. Companies lose ground in four key areas:

INTELLECTUAL PROPERTY
Patent offices don't put years back on the clock just because a company's sales tapered off in a bad economy. This can have a devastating effect on, for instance, pharmaceuticals, where generics constantly challenge proprietary drugs as patents expire.

TECHNOLOGY
Economic downturns can slow the introduction of new technologies, but not for long. Witness the fate of some manufacturers of plasma televisions, which have been forced to exit the business under the double whammy of the downturn and steady improvements in LCD and LED sets.

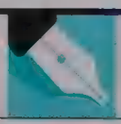
COMPETITION
Companies looking to grow sales in a recession must take market share from competitors. As they press advantage, already weakened companies face possible extinction. In the movie-viewing market, for instance, companies that dominate newer channels have driven bricks-and-mortar retailers into bankruptcy.

CONSUMER TASTES
Novelty wears off, regardless of the economy. Even though they've bought less during the downturn, consumers accustomed to the idea of "fast fashion," for example, will not be interested in last year's styles.

Spotlight

ARTWORK Damián Ortega
Stone—Constructive failures II, 2005
wooden structure, 158 x 80 x 162 cm





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New Business Models In Emerging Markets

Targeting the middle market can be lucrative—but companies won't be able to deliver unless they start from scratch. *by Matthew J. Eyring, Mark W. Johnson, and Hari Nair*

RIGHT NOW more than 20,000 multinationals are operating in emerging economies. According to the *Economist,* Western multinationals expect to find 70% of their future growth there—40% of it in China and India alone. But if the opportunity is huge, so are the obstacles to seizing it. On its 2010 Ease of Doing Business Index, the World Bank ranked China 89th, Brazil 129th, and India 133rd out of 183 countries. Summarizing the bank's conclusions, the *Economist* wrote, "The only way that companies can prosper in these markets is to cut costs relentlessly and accept profit margins close to zero."

Yes, the challenges are significant. But we couldn't disagree more with that opinion. We have seen the opportunities of the future on a street corner in Bangalore, in a small city in central India, in a village in Kenya—and they don't require companies to forgo profits. On the surface, nothing could be more prosaic: a laundry, a compact fridge, a money-transfer service. But look closely at the businesses behind these offerings and you will find the frontiers of business model innovation. These novel ventures reveal a way to help companies escape stagnant demand at home, create new and profitable revenue streams, and find competitive advantage.

That may sound overly optimistic, given the difficulty Western companies have had entering emerging markets to date. But we believe they've struggled not because they can't create viable offerings but because they get their business models wrong. Many multinationals simply import their domestic models into emerging markets. They may tinker at the edges, lowering prices—perhaps by selling smaller sizes or by using lower-cost labor, materials, or other resources. Sometimes they even design and manufacture their products locally and hire local country managers. But their fundamental profit formulas and operating models remain unchanged, consigning these companies to selling largely in the highest income tiers, which in most emerging markets aren't big enough to generate sufficient returns.

PHOTOGRAPHY: STEPHEN WHITE, COURTESY WHITE CUBE

What's often missing from even the savviest of these efforts is a systematic process for reconceiving the business model. For more than a decade, through research and our work in both mature and emerging markets, we have been developing our business model innovation and implementation process (see "Reinventing Your Business Model," HBR December 2008, and "Beating the Odds When You Launch a New Venture," HBR May 2010). At its most basic level, the process consists of three steps: *Identify an important unmet job* a target customer needs done; *blueprint a model* that can accomplish that job profitably for a price the customer is willing to pay; and carefully *implement and evolve the model* by testing essential assumptions and adjusting as you learn.

Start in the Middle

Established companies entering emerging markets should take a page from the strategy of start-ups, for which all markets are new: Instead of looking for additional outlets for existing offerings, they should identify unmet needs—"the jobs to be done" in our terminology—that can be fulfilled at a profit. Emerging markets teem with such jobs. Even the basic needs of their large populations may not yet have been met. In fact, the challenge lies less in finding jobs than in settling on the ones most appropriate for your company to tackle.

Many companies have already been lured by the promise of profits from selling low-end products and services in high volume to the very poor in emerging markets. And high-end products and services are widely available in these markets for the very few who can afford them: You can buy a Mercedes or a washing machine, or stay at a nice hotel, almost anywhere in the world. Our experience suggests a far more promising place to begin: between these two extremes, in the vast middle market. Consumers there are defined not so much by any particular income band as by a common circumstance: Their needs are being met very poorly by existing low-end solutions, because they cannot afford even the cheapest of the high-end alternatives. Companies that devise new business models and offerings to better meet those consumers' needs affordably will discover enormous opportunities for growth.

Emerging markets teem with "jobs to be done." Even the basic needs of their large populations may still be unmet.

Take, for example, the Indian consumer durables company Godrej & Boyce. Founded in 1897 to sell locks, Godrej is today a diversified manufacturer of everything from safes to hair dye to refrigerators and washing machines. In workshops we conducted with key managers in the appliances division, refrigerators emerged as a high-potential area: Because of the cost both to buy and to operate them, traditional compressor-driven refrigerators had penetrated only 18% of the market.

The first thing these managers wanted to know, naturally enough, was "Could Godrej provide a cheaper, stripped-down version of our higher-end refrigerator?" We asked them to consider instead the key needs of those with poor or no refrigeration. Did they know what those consumers really wanted? In a word, no. A small team was assigned to conduct detailed observations, open-ended interviews, and video ethnography to illuminate the job to be done for that untapped market.

The semiurban and rural people the team observed typically earned 5,000 to 8,000 rupees (about $125 to $200) a month, lived in single-room dwellings with four or five family members, and changed residences frequently. Unable to afford conventional refrigerators in their own homes, they were making do with communal, usually secondhand ones.

The shared fridges weren't meeting these people's needs very well, but not for the reasons one might expect. The observers found that they almost invariably contained only a few items. Their users tended to shop daily and buy small quantities of vegetables and milk. Electricity was unreliable, putting even the little food they did want to preserve at risk. What's more, although they wanted to cool their drinking water, making ice wasn't a job for which these people would "hire" a refrigerator.

The team concluded that what this group needed to do was to stretch one meal into two by preserving leftovers and to keep drinks cooler than room temperature—a job markedly different from the one higher-end refrigerators do, which is to keep a large supply of perishables on hand, cold or frozen. Clearly, there was no reason to spend a month's salary on a conventional refrigerator and pay steep electricity prices to get the simpler job done. And just as clearly, the solution wasn't a cheaper conventional fridge. Here was an opportunity to create a fundamentally new product for the underserved middle market.

Targeting this market has two great advantages. First, it's easier to upgrade the solution to a job people are already trying to do than to create sufficient customer demand where none yet exists—as would-be vendors of purified water and other seemingly essential offerings have found to their dismay.

Idea in Brief

Multinationals are looking to emerging markets for future growth. But in trying to transplant their domestic business models, they end up slashing margins or confining themselves to the higher-income tiers, which aren't big enough to generate sufficient returns.

They are overlooking a vast opportunity: the underserved "middle market" of people who struggle to meet basic needs such as refrigeration and clothes washing with low-end options because high-end alternatives are beyond their reach.

To exploit this market, companies must identify important unsatisfied needs, devise fundamentally new business models that can meet them profitably and affordably, and carefully implement and evolve the models by continually testing assumptions and adjusting them.

Second, it's easier to reach people who are already spending money to get their jobs done. That's essentially what Ratan Tata did with the $2,500 Nano. He didn't ask, "How can I get people who've never bought any form of transportation to buy a car?" He asked, "How can I produce a better alternative for people who hire motor scooters to transport their families?" The goal is to redirect existing demand by offering a clear path from an unsatisfactory solution to a better one.

Offer Unique Benefits for Less

To redirect demand, your customer value proposition (CVP) must solve a problem more effectively, simply, accessibly, or affordably than the alternatives. In developing markets, we have found, the components of a CVP that matter most are affordability and access. Let's look at each in turn.

Affordability. Western companies know that they need to come up with lower-cost offerings in emerging markets, but they too often limit themselves to providing less for less. In 2001, for instance, a 300 ml bottle of Coke cost 10 rupees—a day's wages, on average, and a luxury the company estimated only 4% of the population could afford. To reach the other 96%, it introduced a 200 ml bottle and cut the price in half, shaving margins to make Coke more competitive with common alternatives such as lemonade and tea.

In our experience, though, a far more robust approach to creating an affordable emerging market offering is to trade off expensive features and functions that people don't need for less-expensive ones they do need. To get that right requires a clear understanding of the context in which the offering will be sold—which calls for further fieldwork, preferably of a collaborative rather than a merely observational kind. This is good product-development advice in any market. In fact, it applies to indigenous players operating close to home, like Godrej, as well as to Western companies confronting the unfamiliar.

Godrej's team designed and built a prototype cooling unit from the ground up and tested it in the field with consumers. Then, in February 2008, more than 600 women in Osmanabad, a city in India's Marathwada region, gathered to participate in a cocreation event. Working with the original prototypes and several others that had followed, they collaborated with Godrej on every aspect of the product's design. They helped plan the interior arrangements, made suggestions for the lid, and provided insights on color (eventually settling on candy red).

The result was the ChotuKool ("little cool"), a top-opening unit that, at 1.5 x 2 feet and with a capacity of 43 liters, has enough room for the few items users want to keep fresh for a day or two. With only 20 (rather than the usual 200) parts, it has no compressor, cooling tubes, or refrigerant. Instead it uses a chip that cools when a current is applied and a fan like those that prevent desktop computers from overheating. Its top-opening design keeps most of the cold air inside when the lid is opened. It



The final design for the ChotuKool ("little cool") emerged from a cocreation event in Osmanabad, India, in which more than 600 local women participated.



Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

uses less than half the energy of a conventional refrigerator and can run on a battery during the power outages that are common in rural villages. At just 7.8 kilograms, it's highly portable, and at $69, it costs half what the most basic refrigerator does. Because it's the right size for the job, easier to move, and more reliable in a power outage than a conventional fridge, it surpasses the higher-end offering on the performance measures that matter most to these consumers.

Access. It's not surprising that portability is important to potential ChotuKool customers, given that they move frequently. And because populations in emerging markets tend to be dispersed, obtaining goods and services can be more difficult than in the West. This creates opportunities for companies that solve challenges of access.

In Kenya, for example, banking services are scarce and transferring money is complicated and expensive. Without access to traditional services, many people must use unsafe alternatives such as *hawala*—an unregulated network of brokers operating on the honor system—or transport cash by bus.

It's easier to reach people who are already spending money to get jobs done.

The UK-based Vodafone solved this problem by developing a secure, low-cost mobile money-transfer service. Called M-PESA (*M* for "mobile" and *PESA* from the Swahili word for "money"), the system is operated by Safaricom, Kenya's leading mobile network.

Customers register free with an authorized M-PESA agent—typically a Safaricom dealer, but sometimes a gas station, food market, or other local shop. Once registered, they can deposit or withdraw cash at the agent or transfer money electronically to any mobile phone user, even if the recipient is not a Safaricom subscriber. They can also buy Safaricom airtime for themselves or other subscribers. Customers pay a flat fee of about US 40 cents for person-to-person transfers, 33 cents for withdrawals under $33, and 1.3 cents for balance inquiries. Vodafone (which owns a significant stake in Safaricom) manages individual customer accounts on its server, and Safaricom deposits its customers' balances in pooled accounts in two regulated banks, so their full value is backed by highly liquid assets.

Since its launch, in March 2007, the service has acquired more than 9 million customers—40% of Kenya's adult population. As of June 2010, the *Economist* reported, M-PESA customers could conduct transactions at some 17,900 retail outlets, more than half of them in rural areas. That figure dwarfs the total number of bank branches, post offices, and Post Banks—which is only about 840 nationwide.

Spurred by the success of its original offerings, the service has expanded to include bill payment, business-to-customer payments such as paychecks and microfinance loan disbursements, delivery of humanitarian aid, and international money transfers. After just three years M-PESA accounted for 9% of Safaricom's total revenue. More important, it has become the engine driving the company's profits, which have shifted dramatically from voice to data traffic. Vodafone has launched similar services in Tanzania, Afghanistan, and South Africa and plans to introduce them in Egypt, Fiji, and Qatar as well.

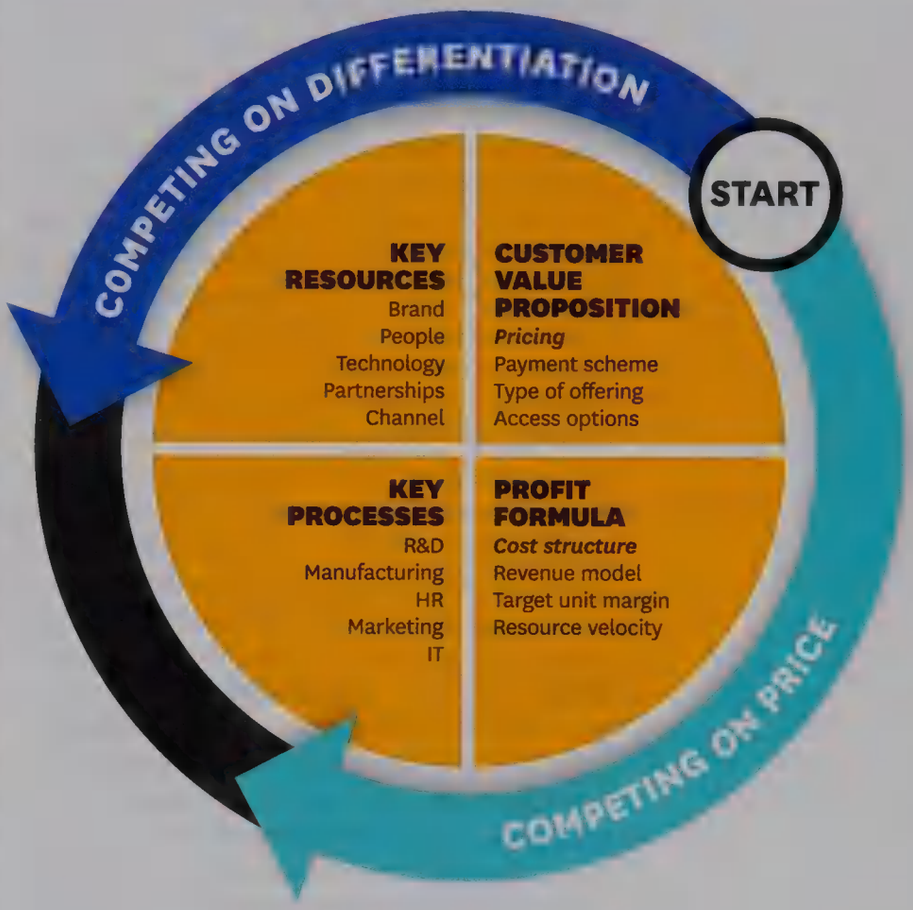
Failure to address the access challenge is an important reason that so many companies have little success adapting their current models to emerging markets. Time and again, the increased volume they hope will offset slimmer profit margins doesn't in fact result in profits, because the costs of serving far-flung customers in infrastructure-poor developing countries are just too high. But companies that, like Vodafone, devise novel approaches may find them to be widely applicable in many markets.

Integrate the Elements

Business models can be conceived in a variety of ways. Our approach focuses on the basics and also on factors that make it difficult to move from an existing model to a new one—margin requirements, overhead, and "resource velocity" (the capacity to generate a given volume of business within a specific time frame). It has four parts: the customer value proposition, a profit formula, key processes, and key resources the company must use to deliver the CVP repeatedly and at scale. Creating competitive advantage lies in integrating these elements to produce value for both the customer and the company. That's easy to say but devilishly hard to do. Mapping the traditional functions of your company

Building a New Model

Business models must integrate four elements: the customer value proposition (CVP), the profit formula, key processes, and key resources. Developing new business models always begins with devising a new CVP. Models designed to compete on differentiation next establish the resources and processes needed to deliver the CVP, the cost of which determines the price required in the profit formula. Models designed to compete on price proceed in the opposite way, establishing first the offering's price, then the cost structure, and finally the processes and resources required.



to these broad categories will show you how much you'd have to change to integrate those functions into a new business model (see the exhibit "Building a New Model").

Once you've devised a CVP for your proposed offering, consider the basis on which you compete—differentiation or price. Offerings that compete on differentiation require that you ask, "What do I have to do to produce this?" which leads you counterclockwise around the model, looking first at what resources and processes are needed, the cost of which (both fixed and variable) will determine what price can deliver the desired profit margin. That's what Whole Foods did when it created a new market for organic foods. Costs drove prices.

For offerings that compete on the basis of price, you move clockwise around the model, again starting with the CVP, but next setting the price, devising a rough cost structure, and then determining what processes and resources (often radically different from those in your current model) are needed to meet your price requirements. Because affordability is so critical in emerging markets, the decision journey is almost invariably clockwise. Innovators start with a revenue model—"We think we can sell this offering to X number of people at price Y"—and then devise the cost structure required to deliver a certain unit margin. Becoming profitable at that margin means operating at a certain resource velocity, which in turn drives decisions about how to organize operations, what materials to use, and other questions.

More often than not, this exercise reveals that a company can't meet its profit goals in emerging markets merely by reducing variable costs in its current profit formula and that a viable model will require changes to fixed costs or overhead as well. That's what Ratan Tata discovered when he set out to produce his $2,500 car. He couldn't just send the car down the production line and somehow spend less to make it. He needed to reduce fixed costs by designing a car with far fewer parts and changing assembly methods and other key processes. Implementing models that require changes in overhead, margins, or resource velocity tends to be problematic for incumbent companies, which is why it's not surprising that start-ups so often have the edge in bringing to market offerings that require new ways to turn a profit. An open mind is perhaps the most important asset anyone can bring to emerging markets. We learned that lesson when we set out to solve a basic but knotty cleaning problem for a vast group of frustrated consumers.

Village Laundry Service—which was founded by our company and uses the Chamak brand—was aimed squarely at the emerging middle market. In India people who can't afford a washing machine but want an alternative to laborious washing by hand after a long day's work have unappealing choices: They can patronize a *dhobi* (a traditional washing person), or they can take their clothes to a neighborhood laundry or dry-cleaning establishment. The dhobis are cheap, but they use any available water, which can be unhygienic. They slap the clothes against rocks to clean them, which wears down the fabrics, and they don't compensate customers for damage. Turnaround time is five to seven days. A laundry or dry cleaner can do the job in four or five days, generally returns the clothes in good shape, and makes

amends if something goes wrong. A laundry may or may not use clean water, however, and both are far more expensive than a dhobi.

In early 2009 we ventured into several parts of India, from urban slums to rural villages, conducting interviews and immersing ourselves in the lives of the people who faced this frustrating choice. What, exactly, was the job to be done? What sort of laundry service would these customers hire? We discovered several things: The job wasn't to make it affordable for them to clean their clothes the way rich people did; it was to replicate the advantage of a home washer and dryer at a price they could afford. It wouldn't be sufficient to get the clothes back in four days—they'd have to be ready within 24 hours, and at a price well below the laundry's or dry cleaner's. And they'd have to be easy to pick up at a nearby location.

With those requirements clearly in mind, we examined all parts of the business model to come up with an inventive way of extending access while keeping costs low. We immediately realized that it would be hard to create a profitable business that placed many traditional self-service laundries across a town, because demand was unpredictable and upfront capital investment and rental deposits would be high. Our solution: Portable seven-foot-square kiosks, each holding an efficient front-loading washer and a dryer, which can be placed wherever there is heavy foot traffic. Customers drop off their clothes to be washed, dried, and ironed, all within 24 hours. The kiosk's small footprint minimizes rents, and its independent water supply, delivered through a fixed contract, is both less expensive and more reliable than the public utility connection. Covered with ads for the Chamak brand, the kiosks also serve as billboards, reducing the need for paid advertising. We keep transaction costs low through an innovative point-of-sale system, made up of a cell phone linked to a Bluetooth printer and report server, which prints receipts, tracks orders, and captures data on business volume.

After much experimentation, we developed standard procedures for staffing and running the kiosks, including tests to gauge potential operators' aptitude and commitment; simple picture-based operating instructions (much like those used in fast-food restaurants) to ensure consistent service; and a scorecard for traffic level, customer satisfaction, marketing effectiveness, and other variables, allowing us to predict the chances of success at each location and to make operations replicable and scalable.

It is this innovative marriage of a novel solution with all the other elements of the business model that makes Chamak's services affordable and profitable. The model allows the company to charge 40 rupees (about $1) per kilogram of clothing—little more than what dhobis charge and significantly less than what professional laundries and dry cleaners do (sometimes 90 rupees per garment). Village Laundry Service currently has 5,000 customers patronizing some 20 booths in Mumbai, Bangalore, and Mysore. The company expects to reach breakeven in late 2011. Of course, as with any new business, how Village Laundry Service performs over the long term will depend on a number of hard-to-predict factors.

From Blueprint to Operating Business

Testing and implementing the business model blueprint in emerging markets is as much an art as a science. Having a cadre of global "experts" study the

Four Ways to Uncover Unmet Needs

Study what your customers are doing with your product. Be aware that, as Peter Drucker famously said, "The customer rarely buys what the business thinks it sells him."

Look at the alternatives to your offerings that consumers buy. Investigate a wide range of substitutes for your products, not just what your competitors make.

Watch for compensating behaviors. Discover what jobs people are satisfying poorly.

Search for explanations. Uncover the root causes of consumers' behavior by asking what people are trying to accomplish with the goods and services they use.

market for months and create a plan that is then handed over to the local team for execution simply doesn't work. Quick adjustments based on early lessons learned on the ground trump the best and most detailed strategic plan developed before the fact.

M-PESA succeeded in part because Kenya's banking regulator permitted Safaricom to test various business models from the very beginning. Safaricom made the most of the opportunity. It started in 2004 by experimenting with 500 customers and a system designed to allow them to repay microloans. As the company market-tested this concept, it discovered a more-compelling value proposition—namely, a way for urban workers to transfer funds to friends and family members in rural areas. That fundamental insight was the basis on which subsequent services were built, and since M-PESA's commercial launch, its simple but powerful branding message has been "Send money home."

This doesn't mean that expertise is unimportant when launching a new business in an emerging market. But we've found that agile functional expertise is the most critical kind, because the uncertainties in emerging markets are so great. A broad network of resources—including responsive advertising agencies, companies that can produce prototypes on demand, financial service advisers who understand local regulatory guidelines, and a healthy bench of local entrepreneurs to execute the plan—is essential.

The ability to conduct rapid experiments inexpensively and use what you learn from them to hone the business model is essential to success. It allows you to make course corrections before you commit to major operational or strategic investments. Recently a company we incubated was looking to launch a men's grooming business but was uncertain about demand. Rather than commission an expensive 10-city quantitative research study, we rented a small air-conditioned truck and created a mini hair salon on wheels, outfitted with a barber's chair, scissors and other implements, and a mirror. For two weeks we drove the truck around the streets of Bangalore to gauge demand and test various pricing scenarios at various locations. The experiment, which cost all of $3,000, provided essential answers that no survey could have and demonstrated the business potential for an affordable and convenient Supercuts-like business for men. The company changed from a roving barbershop model to a kiosk-based model and is considering offering additional services, such as facials and skin lightening, that many customers desire.

An open mind is perhaps the most important asset anyone can bring to emerging markets.

Ultimately, the potential for such business model innovations, as for many other disruptive innovations, may extend far beyond the markets for which they were created. G. Sunderraman, the vice president of corporate development at Godrej, sees the ChotuKool as a new growth platform. Unit sales are projected to reach 10,000 in the first year and 100,000 by the end of the second. If Godrej considered the ChotuKool to be simply a no-frills refrigerator for the middle market, it might be content with a moderate penetration rate. But the company's managers regard it as a new product category, based on new technology, that has the potential to perform jobs for people at many income levels. In areas with frequent power outages, the owners of conventional refrigerators might want an inexpensive and reliable backup. Small shops, offices, and manufacturing sites might use it to maintain a supply of cool drinks. Higher-income customers—perhaps in developed economies as well—might use it in their bedrooms, their cars, or their boats. When the technology improves, Godrej believes, it can enter mainstream markets as ChotuKool changes consumers' expectations about refrigerator prices and performance and addresses a need that previously went unmet.

MANY COMPANIES view emerging markets as one large foothold market, and in this they are right. Classic disruptive innovation theory holds that, ideally, innovations should first be introduced in markets where the alternatives fall short on some dimension (typically price) or are utterly unavailable. Emerging markets fit that bill in spades. They are excellent arenas for trying out product innovations far from competitors' prying eyes. But we are convinced that a much greater opportunity lies in viewing these markets not as one vast lab for *product* R&D but as unique environments filled with poorly done jobs that could be creatively addressed with *business model* R&D. Creating new business models will give your company a more enduring competitive advantage.

HBR Reprint R1101E

Spotlight

When Your Business Model Is in Trouble

Columbia Business School professor **Rita Gunther McGrath** studies strategy in highly uncertain, volatile environments. She spoke recently with HBR executive editor Sarah Cliffe about how to recognize an oncoming crisis—and seize opportunities to get ahead of competitors.



HBR: Why is there so much interest in business model innovation right now?

McGrath: I see three main reasons. The first is the increasing speed of everything. Product life cycles and design cycles are getting shorter. When the pace of change gets faster, people realize that they need to look for the next big thing. The second issue is inter-industry competition. Competition is coming from unexpected places. Who could have anticipated that the iPad's success would put all kinds of display devices—like electronic photo frames—out of business? And the third trend is disruptions from business models that offer better customer experiences instead of simply products. Traditional toy retailers are struggling, but Build-a-Bear gets people to pay good money to provide free labor and make their product themselves. Maxine Clark, the entrepreneur who thought that up, was brilliant!

Which industries are facing the biggest disruptions?

You'd do better to ask which industries are *not* being disrupted. Oil and gas are probably stable. Some consumer packaged goods are, too. But if you don't have strong barriers to entry or you're up against shifts in technology or regulation, you're going to face new kinds of competition. It's just so easy for someone to come after you once you've demonstrated that a market exists.

What are the signs that a business model is running out of gas?

The first clear stage is when next-generation innovations offer smaller and smaller improvements. If your people have trouble thinking of new ways to enhance your offering, that's a sign. Second, you hear customers saying that new alternatives are increasingly acceptable to them. And finally, the problem starts to show up in your financial numbers or other performance indicators.

There's always very early evidence that a business model is in trouble, but it usually gets ignored or dismissed. That's because at most companies the people at the top got there because of their success with the current model—so they have very few incentives to question its durability. So you get a denial reaction initially, followed by desperate attempts to eke just a little more time out of the existing model. The recognition that things must change happens only when it is far too late, and then change is much more painful than it had to be.

Are there any business models—like the experience providers you mentioned—that are on their way up?

Some business models are more powerful than others. Basically, you should look for models that create customer stickiness or loyalty or barriers to entry. Anything that gets automatically renewed gives you



PHOTOGRAPHY: PETER MURPHY

a certain amount of stickiness, especially if the customer has to work to change providers. Anyone who has ever tried to move from one cell phone service to another while holding on to their phone number has experienced this—it's a time-consuming hassle. One reason companies are so motivated to get you to manage your accounts online with them is that once you do, it takes serious work to discontinue the relationship. Anything where your service is embedded into the clients' service, so that clients depend on you to provide critical steps in their processes, is sticky. IBM, for example, gains this advantage when it takes over portions of a client's computing processes. In those models customers aren't going to abandon you unless you get arrogant or greedy. Then there are the platform models. Microsoft is a classic example. It doesn't just sell application software—it makes a lot of money licensing software platforms to other organizations. Platforms allow you to charge more and to hold on to an advantage for a long time.

What models should be avoided?

Those where the customer buys something once and is done. Also—and this is a bigger problem than you'd think—make sure you have a revenue model! People are starting businesses that give away a lot for free. Sometimes that's OK if you can experiment at low cost or you have patient venture capitalists. But you really want a model with a clear path to monetization.

Say you're meeting with a company that wants to reinvent its model. Who should be in the room?

Wait, back up. First you need to have processes in place that cause you to challenge the existing assumptions in your model. For example, Andrea Jung ran Avon very successfully, but then it got into big trouble. One of her advisers suggested that if things were going so badly that she was about to lose her job, maybe she should fire herself on Friday afternoon and rehire herself on Monday morning, and then look at everything in the company with fresh eyes. This led Jung to make some very tough choices—cutting 25% of her own handpicked managers, changing marketing programs, and reversing course on investments she had previously advocated.

So the first step is to build mechanisms that cause you to reexamine your assumptions. One question I encourage people to ask is, What data would lead us to make a different decision? Be sure you're not getting only information that confirms your preexisting

Do you have questions or comments about this article? The author will respond to reader feedback at **hbr.org**.

The Street doesn't like it if you decide to get out of an older business. But private equity firms like it a lot.

beliefs. Then you can think about what nontraditional information to seek out. You need to get unfiltered information by talking to customers directly and by going through the experiences they go through. You want to get out of the room, in other words. Do your own version of *Undercover Boss* and see what insights you can get. I'll never forget an experience I had with classroom participants from a wireless telecom company that was regularly criticized for poor network coverage. When I asked them, "Why are your senior managers not bothered by this?" they said, "We know where their offices are, what routes they take to work, and where they go on weekends. We make sure the network is working in those places." This insulation from reality can be deadly. You need direct contact with the truth.

Once you've done all that, then you can bring together a diverse group—people who know something about the technology, people who understand customer needs, people who have a longer view of where things might be evolving—and develop hypotheses about the areas where you should experiment.

How do you choose among possible experiments to invest in?

You need a portfolio of opportunities. I believe in investing in several options: Some will pay off, and some won't. Some of them might be mutually exclusive. Verizon, for example, knew that landline telephones were disappearing. A lot of companies would have just milked that business for the cash cow that it was, but Ivan Seidenberg took out investments in four or five mutually exclusive networking technologies and let them run until it became clear which one would be dominant. Then he invested heavily in that technology and shut the others down. Most companies don't do that. Instead, they fund the one project with the best numbers.

What's the right pace for change if you're still making good money from your existing businesses and you've got this portfolio of new investments?

That's one of the most difficult issues—I wish I had a clear answer for you. The best attempt we've made is to calculate what we call bare-bones net present values: Make some guesses about when the cash flows from new businesses will come onstream. Then figure out how to get cash out of your declining businesses or find another way to benefit from them. For instance, you can license technology to others who still have an interest in it. You can continue to run the business but outsource its operations to a lower-cost provider. That transition period is tough, but it's good to spend time thinking through the issues.

I'm guessing that shareholders aren't especially patient with the messiness of those transitions.

You've got that right. If a company needs to get out of a business—take write-offs, get rid of assets—the Street doesn't like that. But private equity firms like it a lot. A fair number of firms going through a big business model change right now are partially or wholly in the hands of private equity players, and I don't think that's an accident. Some of the more-enlightened companies I've spoken with have talked about recruiting investors who are willing to be patient.

Do family-controlled businesses have a better record of patient investing?

Without a doubt. Bose recently released a product called VideoWave, which creates a high-end home theater. The company spent five years developing it. That's a long time to wait for new revenues. But the people at Bose think that because they had the patience to get it right, the premium-price advantage and the business model will last. They can invest in deep science because they've maintained private ownership for a long, long time. They've looked at the stock market and said, "Nope, not for us."

I suspect we'll see a different approach to investment coming out of this wave of business model changes. Think about it: Do the capital markets operate in a way that encourages companies to make the right kinds of decisions as they face large-scale change? I'm dubious.

Anything else companies can do to turn threats to their models into opportunities?

When companies don't respond to business model challenges, it's usually because of internally generated problems like the lack of incentives I mentioned earlier and too much distance from the customer. I would encourage managers to think about what internal issues they should be tackling right now. Because when everything's fine, when your model is chugging along and you're doing your day job, it's easy to ignore those issues. Organizations have powerful inertia. It's like kids. At night, can you get them to go to bed? No. In the morning, can you get them to wake up? No. They want to keep doing whatever it is they're doing. Organizations are just the same.

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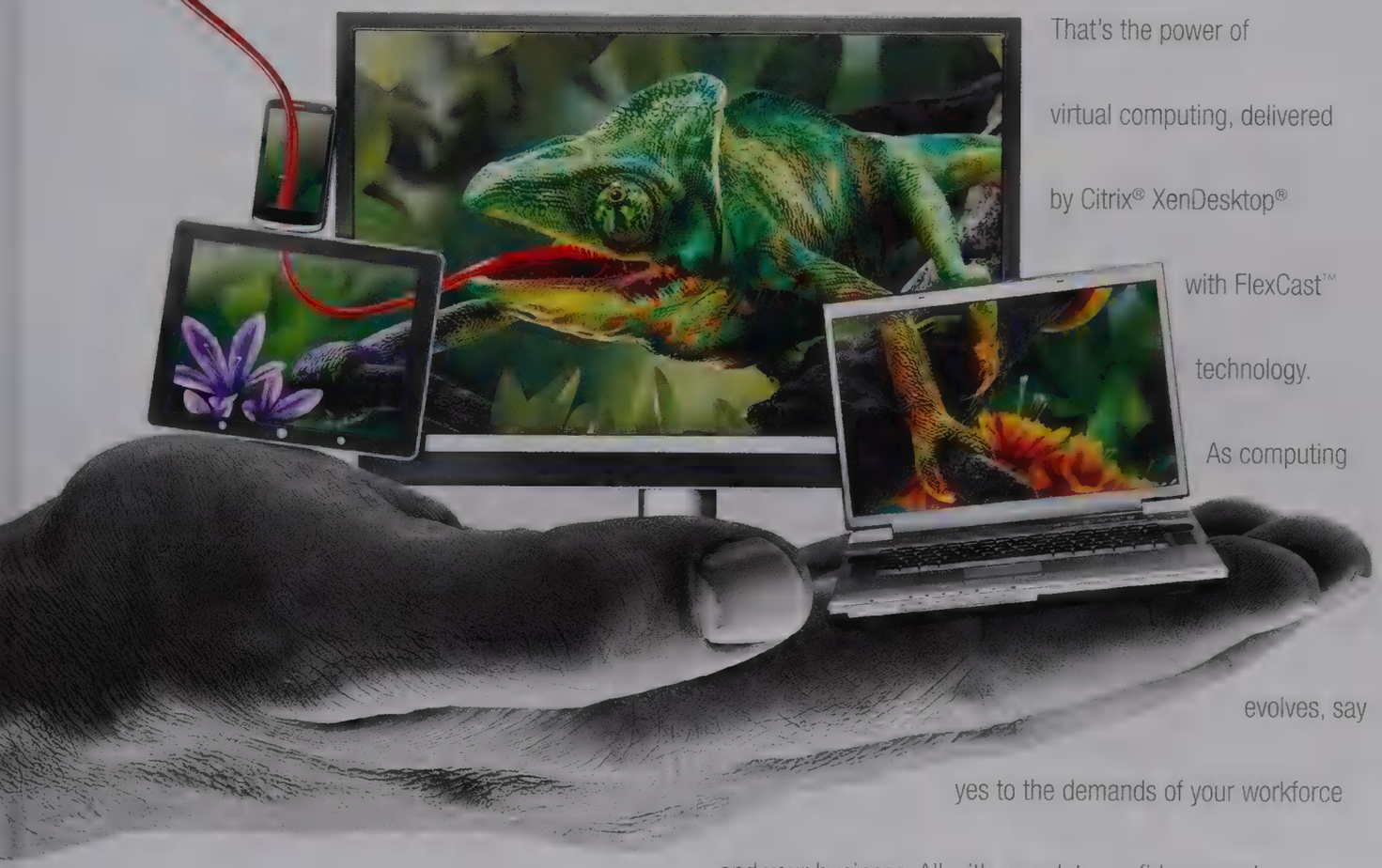
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Spotlight

ARTWORK Damián Ortega
Controller of the Universe, 2007
found tools and wire, 285 x 405 x 455 cm





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How to Design A Winning Business Model

Smart companies' business models generate cycles that, over time, make them operate more effectively. *by Ramon Casadesus-Masanell and Joan E. Ricart*

STRATEGY HAS been the primary building block of competitiveness over the past three decades, but in the future, the quest for sustainable advantage may well begin with the business model. While the convergence of information and communication technologies in the 1990s resulted in a short-lived fascination with business models, forces such as deregulation, technological change, globalization, and sustainability have rekindled interest in the concept today. Since 2006, the IBM Institute for Business Value's biannual Global CEO Study has reported that senior executives across industries regard developing innovative business models as a major priority. A 2009 follow-up study reveals that seven out of 10 companies are engaging in business-model innovation, and an incredible 98% are modifying their business models to some extent. Business model innovation is undoubtedly here to stay.

That isn't surprising. The pressure to crack open markets in developing countries, particularly those at the middle and bottom of the pyramid, is driving a surge in business-model innovation. The economic slowdown in the developed world is forcing companies to modify their business models or create new ones. In addition, the rise of new technology-based and low-cost rivals is threatening incumbents, reshaping industries, and redistributing profits. Indeed,

the ways by which companies create and capture value through their business models is undergoing a radical transformation worldwide.

Yet most enterprises haven't fully come to grips with how to compete through business models. Our studies over the past seven years show that much of the problem lies in companies' unwavering focus on creating innovative models and evaluating their efficacy in isolation—just as engineers test new technologies or products. However, the success or failure of a company's business model depends largely on how it interacts with models of other players in the industry. (Almost any business model will perform brilliantly if a company is lucky enough to be the only one in a market.) Because companies build them without thinking about the competition, they routinely deploy doomed business models.

Our research also shows that when enterprises compete using business models that differ from one another, the outcomes are difficult to predict. One business model may appear superior to others when analyzed in isolation but create less value than the others when interactions are considered. Or rivals may end up becoming partners in value creation. Appraising models in a stand-alone fashion leads to faulty assessments of their strengths and weaknesses and bad decision making. This is a big reason why so many new business models fail.

Moreover, the propensity to ignore the dynamic elements of business models results in many companies failing to use them to their full potential. Few executives realize that they can design business models to generate winner-take-all effects that resemble the network externalities that high-tech companies such as Microsoft, eBay, and Facebook have created. Whereas network effects are an exogenous feature of technologies, winner-take-all effects can be triggered by companies if they make the right choices in developing their business models. Good business models create virtuous cycles that, over time, result in competitive advantage. Smart companies know how to strengthen their virtuous cycles, weaken those of rivals, and even use their virtuous cycles to turn competitors' strengths into weaknesses.

"Isn't that strategy?" we're often asked. It isn't—and unless managers learn to understand the distinct realms of business models, strategy, and tactics, while taking into account how they interact, they will never find the most effective ways to compete.

What Is a Business Model, Really?

Everyone agrees that executives must know how business models work if their organizations are to thrive, yet there continues to be little agreement on an operating definition. Management writer Joan Magretta defined a business model as "the story that

Three Characteristics of a Good Business Model

How can you tell if a business model will be effective? A good one will meet three criteria.

Is it aligned with company goals?

The choices made while designing a business model should deliver consequences that enable an organization to achieve its goals. This may seem obvious until you consider a counterexample. In the 1970s, Xerox set up Xerox PARC, which spawned technological innovations such as laser printing, Ethernet, the graphical user interface, and very large scale integration for semiconductors. However, Xerox PARC was notoriously unable to spawn new businesses or capture value from its innovations for the parent due to a distressing lack of alignment with Xerox's goals.

Is it self-reinforcing?

The choices that executives make while creating a business model should complement one another; there must be internal consistency. If, ceteris paribus, a low-cost airline were to decide to provide a level of comfort comparable to that offered by a full-fare carrier such as British Airways, the change would require reducing the number of seats on each plane and offering food and coffee. These choices would undermine the airline's low-cost structure and wreck its profits. When there's a lack of reinforcement, it's possible to refine the business model by abandoning some choices and making new ones.

Is it robust?

A good business model should be able to sustain its effectiveness over time by fending off four threats, identified by Pankaj Ghemawat. They are *imitation* (can competitors replicate your business model?); *holdup* (can customers, suppliers, or other players capture the value you create by flexing their bargaining power?); *slack* (organizational complacency); and *substitution* (can new products decrease the value customers perceive in your products or services?). Although the period of effectiveness may be shorter nowadays than it once was, robustness is still a critical parameter.

Idea in Brief

There has never been as much interest in business models as there is today; seven out of 10 companies are trying to create innovative business models, and 98% are modifying existing ones, according to a recent survey.

However, most companies still create and evaluate business models in isolation, without considering the implications of how they will interact with rivals' business models. This narrow view dooms many to failure.

Moreover, companies often don't realize that business models can be designed so that they generate virtuous cycles—similar to the powerful effects high-tech firms such as Facebook, eBay, and Microsoft enjoy. These cycles, when aligned with company goals, reinforce competitive advantage.

By making the right choices, companies can strengthen their business models' virtuous cycles, weaken those of rivals, and even use the cycles to turn competitors into complementary players.

This is neither strategy nor tactics; it's using business models to gain competitive advantage. Indeed, companies fare poorly partly because they don't recognize the differences between strategy, tactics, and business models.

explains how an enterprise works," harking back to Peter Drucker, who described it as the answer to the questions: Who is your customer, what does the customer value, and how do you deliver value at an appropriate cost?

Other experts define a business model by specifying the main characteristics of a good one. For example, Harvard Business School's Clay Christensen suggests that a business model should consist of four elements: a customer value proposition, a profit formula, key resources, and key processes. Such descriptions undoubtedly help executives evaluate business models, but they impose preconceptions about what they should look like and may constrain the development of radically different ones.

Our studies suggest that one component of a business model must be the choices that executives make about how the organization should operate—choices such as compensation practices, procurement contracts, location of facilities, extent of vertical integration, sales and marketing initiatives, and so on. Managerial choices, of course, have consequences. For instance, pricing (a choice) affects sales volume, which, in turn, shapes the company's scale economies and bargaining power (both consequences). These consequences influence the company's logic of value creation and value capture, so they too must have a place in the definition. In its simplest conceptualization, therefore, a business model consists of a set of managerial choices and the consequences of those choices.

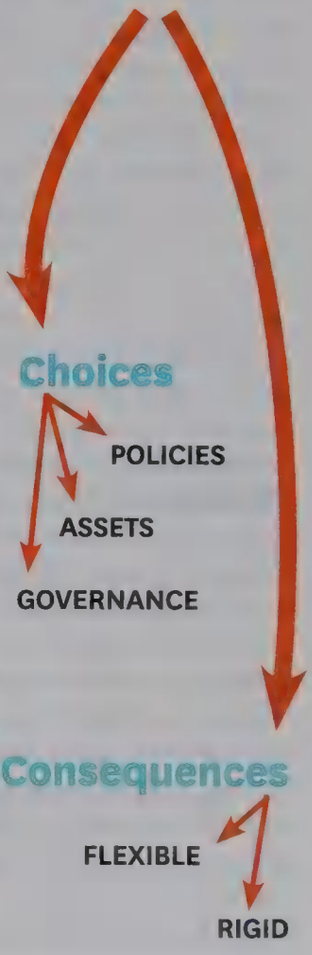
Companies make three types of choices when creating business models. *Policy choices* determine the actions an organization takes across all its operations (such as using nonunion workers, locating plants in rural areas, or encouraging employees to fly coach class). *Asset choices* pertain to the tangible resources a company deploys (manufacturing facilities or satellite communication systems, for instance). And *governance choices* refer to how a company arranges decision-making rights over the other two (should we own or lease machinery?). Seemingly innocuous differences in the governance of policies and assets influence their effectiveness a great deal.

Consequences can be either flexible or rigid. A flexible consequence is one that responds quickly when the underlying choice changes. For example, choosing to increase prices will immediately result in lower volumes. By contrast, a company's culture of frugality—built over time through policies that oblige employees to fly economy class, share hotel rooms, and work out of Spartan offices—is unlikely to disappear immediately even when those choices change, making it a rigid consequence. These distinctions are important because they affect competitiveness. Unlike flexible consequences, rigid ones are difficult to imitate because companies need time to build them.

Take, for instance, Ryanair, which switched in the early 1990s from a traditional business model to a low-cost one. The Irish airline eliminated all frills, cut costs, and slashed prices to unheard-of levels. The choices the company made included offering low fares, flying out of only secondary airports, catering to only one class of passenger, charging for all additional services, serving no meals, making only short-haul flights, and utilizing a standardized fleet of Boeing 737s. It also chose to use a nonunionized workforce, offer high-powered incentives to employees, operate out of a lean headquarters, and so on. The consequences of those choices were high volumes, low variable and fixed costs, a reputation for reasonable fares, and an aggressive management team, to name a few. (See "Ryanair's Business Model Then and Now.") The result is a business model that enables Ryanair to offer a decent level of service at a low cost without radically lowering customers' willingness to pay for its tickets.

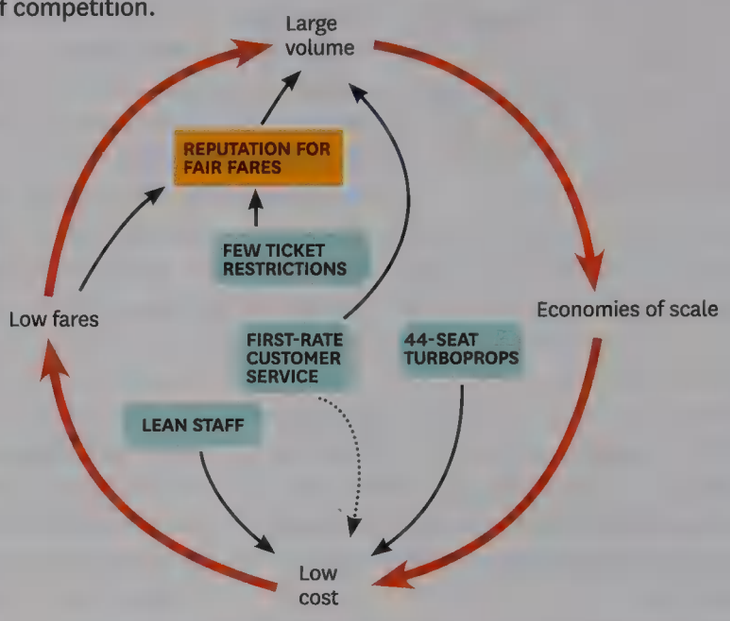
Business Model

A business model comprises choices and consequences.



Ryanair's Business Model Then

This depiction of Ryanair's business model in the 1980s highlights the airline's major choices at the time: offering excellent service and operating with a standardized fleet. The airline was forced to redesign its business model in the face of stiff competition.



How Business Models Generate Virtuous Cycles

Not all business models work equally well, of course. Good ones share certain characteristics: They align with the company's goals, are self-reinforcing, and are robust. (See the sidebar "Three Characteristics of a Good Business Model.") Above all, successful business models generate virtuous cycles, or feedback loops, that are self-reinforcing. This is the most powerful and neglected aspect of business models.

Our studies show that the competitive advantage of high-tech companies such as Apple, Microsoft, and Intel stems largely from their accumulated assets—an installed base of iPods, Xboxes, or PCs, for instance. The leaders gathered those assets not by buying them but by making smart choices about pricing, royalties, product range, and so on. In other words, they're consequences of business model choices. Any enterprise can make choices that allow it to build assets or resources—be they project management skills, production experience, reputation, asset utilization, trust, or bargaining power—that make a difference in its sector.

The consequences enable further choices, and so on. This process generates virtuous cycles that continuously strengthen the business model, creating a dynamic that's similar to that of network effects. As the cycles spin, stocks of the company's key assets (or resources) grow, enhancing the enterprise's competitive advantage. Smart companies design business models to trigger virtuous cycles that, over time, expand both value creation and capture.

For example, Ryanair's business model creates several virtuous cycles that maximize its profits through increasingly low costs and prices. (See the exhibit "Ryanair's Key Virtuous Cycles.") All of the cycles result in reduced costs, which allow for lower prices that grow sales and ultimately lead to increased profits. Its competitive advantage keeps growing as long as the virtuous cycles generated by its business model spin. Just as a fast-moving body is hard to stop because of kinetic energy, it's tough to halt well-functioning virtuous cycles.

However, they don't go on forever. They usually reach a limit and trigger counterbalancing cycles, or they slow down because of their interactions with other business models. In fact, when interrupted, the synergies work in the opposite direction and erode competitive advantage. For example, one of Ryanair's cycles could become vicious if its employees unionized and demanded higher wages, and the airline could no longer offer the lowest fares. It would then lose volume, and aircraft utilization would fall. Since Ryanair's investment in its fleet assumes a very high rate of utilization, this change would have a magnified effect on profitability.

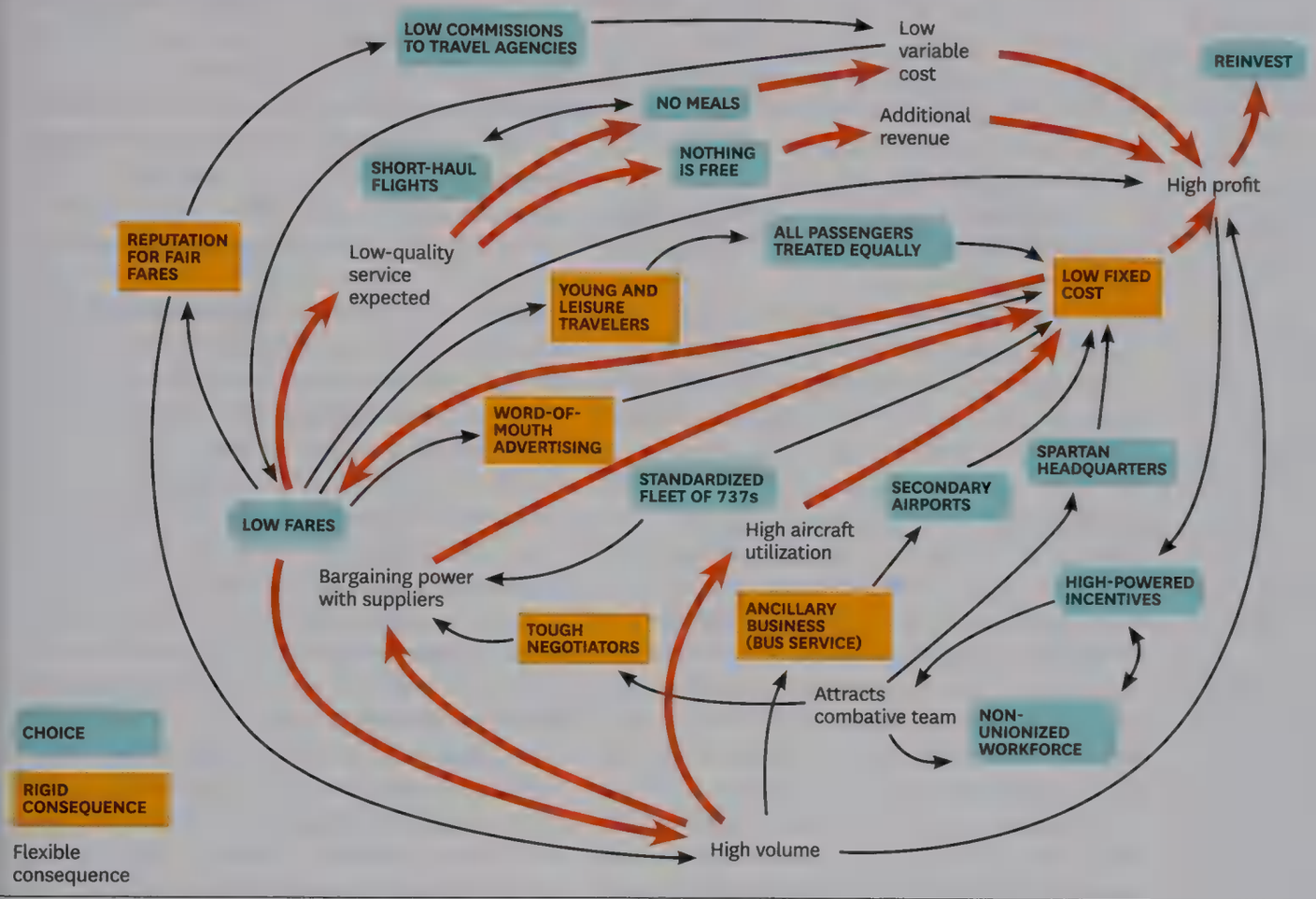
It's easy to see that virtuous cycles can be created by a low-cost, no-frills player, but a differentiator may also create virtuous cycles. Take the case of Irizar, a Spanish manufacturer of bodies for luxury motor coaches, which posted large losses after a series of ill-conceived moves in the 1980s. Irizar's leadership changed twice in 1990 and morale hit an all-time low, prompting the new head of the company's steering team, Koldo Saratxaga, to make major changes. He transformed the organization's business model by making choices that yielded three rigid consequences: employees' tremendous sense of ownership, feelings of accomplishment, and trust. The choices included eliminating hierarchy, decentralizing decision making, focusing on teams to get work done, and having workers own the assets. (See the exhibit "Irizar's Novel Business Model.")

RYANAIR'S KEY VIRTUOUS CYCLES

CYCLE 1 Low fares → High volumes → Greater bargaining power with suppliers → Lower fixed costs → Even lower fares
CYCLE 2 Low fares → High volumes → High aircraft utilization → Low fixed cost per passenger → Even lower fares
CYCLE 3 Low fares → Expectations of low-quality service → No meals offered → Low variable costs → Even lower fares

Ryanair's Business Model Now

Ryanair's current business model rests on the key choices of offering customers low fares and providing nothing free. The rigid consequences include a reputation for fair fares and low fixed costs. Ryanair's choices are aligned with its goals, generate cycles that reinforce the business model, and are robust given that it has been operating as a low-cost airline for 20 years.



Irizar's main objective, as a cooperative, is to increase the number of well-paying jobs in the Basque Country, so the company developed a business model that generates a great deal of customer value. Its key virtuous cycle connects customers' willingness to pay with relatively low cost, generating high profits that feed innovation, service, and high quality. In fact, quality is the cornerstone of Irizar's culture. Focusing on customer loyalty and an empowered workforce, the company enjoyed a 23.9% compound annual growth rate over the 14 years that Saratxaga was CEO. Producing 4,000 coaches in 2010 and generating revenues of about €400 million, Irizar is an example of a radically different business model that generates virtuous cycles.

Competing with Business Models

It's easy to infuse virtuousness in cycles when there are no competitors, but few business models operate in vacuums—at least, not for long. To compete with rivals that have similar business models, companies must quickly build rigid consequences so that they can create and capture more value than rivals do. It's a different story when enterprises compete against dissimilar business models; the results are often unpredictable, and it's tough to know which business model will perform well.

Take, for instance, the battle between two of Finland's dominant retailers: S Group, a consumers' cooperative, and Kesko, which uses entrepreneur-retailers to own and operate its stores. We've tracked the firms for over a decade, and Kesko's business model appears to be superior: The incentives it offers franchisees should result in rapid growth and high profits. However, it turns out that the S Group's business model hurts Kesko more than Kesko's affects the S Group. Since customers own the S Group, the retailer often reduces prices and increases customer bonuses, which allows it to gain market share from Kesko. That forces Kesko to lower its prices and its profits fall, demotivating its entrepreneur-retailers. As a result, Kesko underperforms the S Group. Over

Irizar's Novel Business Model

When Irizar—a Spanish cooperative that manufactures luxury motor coach bodies—created a radically different business model, it made several innovative choices.

SHARED OWNERSHIP

- Workers own assets and contribute financially to join Irizar
- Teams set their own goals and choose leaders
- No bosses, only coordinators
- Flat hierarchy, with only three levels
- No overtime pay

TRUST

- Decentralized decision making
- Shared information and transparency about performance
- No walls inside plants or offices; no assigned parking spaces
- Tenure after three years of probation; no evaluation or firings thereafter
- No clocking in and out

QUALITY

- Only one product for all markets
- Most repetitive tasks outsourced

ACCOMPLISHMENT

- Relatively high product prices
- Pay scale ratio of just 3:1
- Some profit (or loss) sharing every year

These choices have led to innovation, high quality, and excellent service, generating high sales volume as well as customer loyalty.

time, the S Group's opaque corporate governance system allows slack to creep into the system, and it is forced to hike prices. This allows Kesko to also increase prices and improve profitability, drive its entrepreneur-retailers, and win back more customers through its superior shopping experience. That sparks another cycle of rivalry.

Companies can compete through business models in three ways: They can strengthen their own virtuous cycles, block or destroy the cycles of rivals, or build complementarities with rivals' cycles, which results in substitutes mutating into complements.

Strengthen your virtuous cycle. Companies can modify their business models to generate new virtuous cycles that enable them to compete more effectively with rivals. These cycles often have consequences that strengthen cycles elsewhere in the business model. Until recently, Boeing and Airbus competed using essentially the same virtuous cycles. Airbus matched Boeing's offerings in every segment, the exception being the very large commercial transport segment where Boeing had launched the 747 in 1969. Given the lumpiness of demand for aircraft, their big-ticket nature, and cyclicality, price competition has been intense.

Historically, Boeing held the upper hand because its 747 enjoyed a monopoly, and it could reinvest those profits to strengthen its position in other segments. Analysts estimate that the 747 contributed 70 cents to every dollar of Boeing's profits by the early 1990s. Since R&D investment is the most important driver of customers' willingness to pay, Airbus was at a disadvantage. It stayed afloat by obtaining low-interest loans from European governments. Without the subsidies, Airbus's cycle would have become vicious.

With the subsidies likely to dry up, Airbus modified its business model by developing a very large commercial transport, the 380. To dissuade Airbus, Boeing announced a stretch version of the 747. However, that aircraft would cut into the 747's profits, so it seems unlikely that Boeing will ever launch it. Not only does the 380 help maintain the virtuousness of Airbus's cycle in small and midsize planes, but also it helps decelerate the virtuousness of Boeing's cycle. The increase in rivalry suggests that the 747 will become less of a money-spinner for Boeing. That's why it is trying to strengthen its position in midsize aircraft, where competition is likely to become even tougher when sales of the 380 take off, by developing the 787.

Weaken competitors' cycles. Some companies get ahead by using the rigid consequences of their choices to weaken new entrants' virtuous cycles. Whether a new technology disrupts an industry or not depends not only on the intrinsic benefits of that technology but also on interactions with other players. Consider, for instance, the battle between Microsoft and Linux, which feeds its virtuous cycle by being free of charge and allowing users to contribute code improvements. Unlike Airbus, Microsoft has focused on weakening its competitor's virtuous cycle. It uses its relationship with OEMs to have Windows preinstalled on PCs and laptops so that it can prevent Linux from growing its customer base. It discourages people from taking advantage of Linux's free operating system and applications by spreading fear, uncertainty, and doubt about the products.

In the future, Microsoft could raise Windows' value by learning more from users and offering special prices to increase sales in the education sector, or decrease Linux's value by undercutting purchases by strategic buyers and preventing Windows applications from running on Linux. Linux's value creation potential may theoretically be greater than that of Windows, but its installed base will never eclipse that of Microsoft as long as the software giant succeeds in disrupting its key virtuous cycles.

Turn competitors into complements. Rivals with different business models can also become partners in value creation. In 1999, Betfair, an online betting exchange, took on British bookmakers such as Ladbrokes and William Hill by enabling people to anonymously place bets against one another. Unlike traditional bookmakers who only offer odds, Betfair is a two-sided internet-based platform that allows customers to both place bets and offer odds to others. One-sided and two-sided businesses have different virtuous cycles: While bookmakers create value by managing risk and capture it through the odds they offer, betting exchanges themselves bear no risk. They create value by matching the two sides of the market and capture it by taking a cut of the net winnings.

Over the past decade, Ladbrokes' and William Hill's gross winnings have declined, so Betfair has hurt them, but not as much as expected. Because Betfair has improved odds in general, gamblers lose less money. They then place more wagers, and when bookies pay out, bettors gamble again, feeding a virtuous cycle. This has expanded the British gambling market by a larger proportion than just the improve-

ment of odds might suggest. The better odds Betfair offers also help traditional bookmakers gauge market sentiment more accurately and hedge their exposures at a lower cost. When a new business model creates complementarities between competitors, it is less likely that incumbents will respond aggressively. The initial reaction from bookmakers to Betfair was hostile, but they have become more accommodating of its presence ever since.

Business Models vs. Strategy vs. Tactics

No three concepts are of as much use to managers or as misunderstood as strategy, business models, and tactics. Many use the terms synonymously, which can lead to poor decision making.

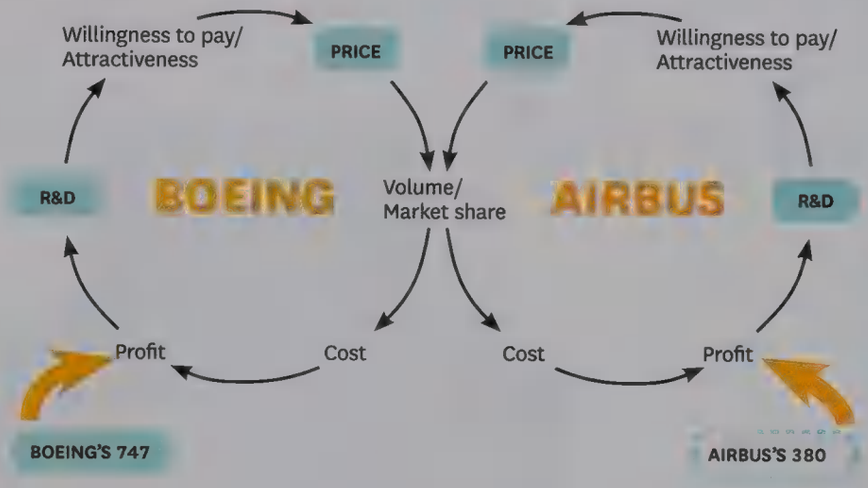
To be sure, the three are interrelated. Whereas business models refer to the logic of the company—how it operates and creates and captures value for stakeholders in a competitive marketplace—strategy is the plan to create a unique and valuable position involving a distinctive set of activities. That definition implies that the enterprise has made a choice about how it wishes to compete in the marketplace. The system of choices and consequences is a reflection of the strategy, but it isn't the strategy; it's the business model. Strategy refers to the contingent plan about which business model to use. The key word is contingent; strategies contain provisions against a range of contingencies (such as competitors' moves or environmental shocks), whether or not they take place. While every organization has a business model, not every organization has a strategy—a plan of action for contingencies that may arise.

Consider Ryanair. The airline was on the brink of bankruptcy in the 1990s, and the strategy it chose to reinvent itself was to become the Southwest Airlines of Europe. The new logic of the organization—its way of creating and capturing value for stakeholders—was Ryanair's new business model.

Changing strategic choices can be expensive, but enterprises still have a range of options to compete that are comparatively easy and inexpensive to deploy. These are tactics—the residual choices open to a company by virtue of the business model that it employs. Business models determine the tactics available to compete in the marketplace. For instance, Metro, the world's largest newspaper, has created an ad-sponsored business model that dictates that the product must be free. That precludes Metro from using price as a tactic.

How Airbus Bolstered Its Business Model

Companies can often strengthen their business models to take on competitors more effectively. Airbus's business model initially fell short because Boeing could reinvest profits from its 747, which enjoyed a monopoly in the very large commercial transport segment. In 2007, Airbus launched the 380 to compete in that segment—strengthening its virtuous cycle relative to Boeing's.



Think of a business model as if it were an automobile. Different car designs function differently—conventional engines operate quite differently from hybrids, and standard transmissions from automatics—and create different value for drivers. The way the automobile is built places constraints on what the driver can do; it determines which tactics the driver can use. A low-powered compact would create more value for the driver who wants to maneuver through the narrow streets of Barcelona's Gothic Quarter than would a large SUV, in which the task would be impossible. Imagine that the driver could modify the features of the car: shape, power, fuel consumption, seats. Such modifications would not be tactical; they would constitute strategies because they would entail changing the machine (the "business model") itself. In sum, strategy is designing and building the car, the business model is the car, and tactics are how you drive the car.

Strategy focuses on building competitive advantage by defending a unique position or exploiting a valuable and idiosyncratic set of resources. Those positions and resources are created by virtuous cycles, so executives should develop business models that activate those cycles. That's tough, especially because of their interactions with those of other players such as competitors, complementors, customers, and suppliers that are all fighting to create and capture value too. That's the essence of competitiveness—and developing strategy, tactics, or innovative business models has never been easy.

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Spotlight

ARTWORK Damián Ortega,
Concrete Cube (black), 2003,
cast concrete with black pigment



The CEO's Role In Business Model Reinvention

A forward-looking CEO must do three things: Manage the present, selectively forget the past, and create the future. *by Vijay Govindarajan and Chris Trimble*



CONSIDER A FEW of the great innovation stories of the past decade: Google, Netflix, and Skype. Now ask yourself, why wasn't Google created by Microsoft? Netflix by Blockbuster? Skype by AT&T?

Why do established corporations struggle to find the next big thing before new competitors do? The problem is pervasive; the examples are countless. The simple explanation is that many companies become too focused on executing today's business model and forget that business models are perishable. Success today does not guarantee success tomorrow.

To assess your company's vulnerability, try this diagnostic: On separate index cards, write down all the important initiatives under way in your organization. Then create three boxes and label them "Box 1: Manage the Present," "Box 2: Selectively Forget the Past," and "Box 3: Create the Future."

Next, take a few minutes to imagine your industry in five, 10, or even 20 years—as far out as you can reasonably foresee. Consider all the forces of change your industry faces—technology, customer demographics, regulation, globalization, and so on. With those forces in mind, put your organization's initiatives in the appropriate boxes: those intended to improve today's business performance in box 1; those aimed at stopping something—underperforming products and services, obsolete policies and practices, outdated assumptions and mind-sets—in box 2; and those that prepare your organization for the long term in box 3.

For companies to endure, they must get the forces of preservation (box 1), destruction (box 2), and creation (box 3) in the right balance. Striking that balance is the CEO's most important task, but most companies overwhelmingly favor box 1. Forces of preservation reign supreme. Forces of destruction and creation are overshadowed, outmatched, and out of luck.

To be sure, the work of preservation—the day-to-day execution of the existing business model—is



Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

vitally important. CEOs must get box 1 right or their tenures will be short. They must concentrate daily on performance excellence and continuous improvement, as companies such as Wal-Mart and Southwest Airlines have done for years. The best box 1 companies are sleek and efficient, like a well-designed automobile. They coordinate an astonishingly complex array of human actions like so many gears, pistons, and camshafts.

But CEOs are not *just* responsible for box 1. They must also get boxes 2 and 3 right. Sadly, most chief executives ignore destruction and creation until it is too late. They bow to a myriad of short-term pressures: intense demands for quarterly earnings, risk aversion, discomfort with uncertainty, resistance to change, linear extrapolation from past experience, and unwillingness to cannibalize established businesses. As a result, many companies fail to transform themselves.

> If organizational memory is not tamed, it gets in the way of creation. Before you can create, you must forget.

The failure may not be immediately apparent, but sooner or later most industries go through nonlinear shifts that threaten incumbents. For instance, breakthroughs in genetic engineering have revolutionized the pharmaceutical industry. New concerns about environmental quality have posed serious threats in energy-intensive sectors. Globalization has opened up India and China, where unfamiliar rivals are challenging established companies with ultra-low-price products.

While most companies neatly manage linear change, they are left befuddled by nonlinear change. Transformation efforts look meek at best, like futilely trying to turn a car into an airplane by bolting on two wings. Consider, for example, Sony's lagging positions in portable music players and electronic book readers, or Nokia's and Motorola's struggles to keep up with the rapid evolution of smartphones.

To win both today and tomorrow, CEOs must operate in all three boxes simultaneously. They must recognize that boxes 2 and 3 are not about what the business will be doing in 20 years; they are about the preparations it must make today. That's easier said than done, for it's not only a matter of balancing resources across the three boxes. The CEO must also know exactly what to destroy and what to create.

On the surface, box 2 is about pruning lines of business that are underperforming or no longer fit the company's strategy. Some companies do that consistently. For decades, for example, Corning has been eliminating mature businesses, such as cookware and light bulbs, to focus on high-growth opportunities. And when Japanese firms commoditized the market for dynamic random-access memory—a key component in PCs—Intel cofounder Andy Grove shifted the company into microprocessors. Such divestitures are traumatic but not conceptually mysterious. Pruning simply requires commitment from powerful executives.

It's harder to take a knife to a less-evident box 2 menace: organizational memory. As managers run the core business, they develop biases, assumptions, and entrenched mind-sets. These become further embedded in planning processes, performance evaluation systems, organizational structures, and human resources policies. Organizational memory is particularly powerful in companies that tend to promote from within and to have homogeneous cultures, strong socialization mechanisms, and long track records of success. Such deeply rooted memory may be great for preservation (box 1), but if it is not tamed sufficiently (box 2), it gets in the way of creation (box 3). That's why all box 3 initiatives must start in box 2. Bottom line: Before you can create, you must forget.

To understand how a company can manage all three boxes successfully, let's look at Infosys Technologies Limited of India.

Business Model Transformation At Infosys

On July 31, 2006, Infosys chairman N.R. Narayana Murthy stood before thousands of employees in Mysore, India, and pressed an orange button. Half a world away, trading commenced on the Nasdaq. His remotely ringing the opening bell, part of Infosys's 25-year anniversary celebration, symbolized how the global economy was being transformed.

For people trying to understand the offshoring phenomenon, Infosys was exhibit A. Indeed, it had inspired Thomas Friedman to write *The World Is*

Idea in Brief

Forward-looking CEOs must harness the power of the past, the present, and the future in three critical disciplines.

	BOX 1 MANAGE THE PRESENT	BOX 2 SELECTIVELY FORGET THE PAST	BOX 3 CREATE THE FUTURE
	YOU ARE ACCUSTOMED TO	YOU MUST RECOGNIZE THAT	SO THAT YOU CAN
STRATEGY MAKING	Data-driven analysis	Rich data about the future are not available. The best you can do is to consider long-term trends and potential nonlinear shifts.	Create a separate, parallel strategy-making process for box 3. Involve nontraditional voices.
ACCOUNTABILITY	Strict accountability for results	The alternative to accountability for results is not anarchy. It is a different kind of accountability.	Hold leaders of box 3 projects accountable for running disciplined experiments.
ORGANIZATIONAL DESIGN	Perfect alignment	An organization that is perfectly aligned can operate only in box 1.	Create zero-based, custom-built subunits for box 3 projects.

Flat. The company had demonstrated that its core service, custom software development for corporations, did not have to happen at the client site. Most of the work could be done thousands of miles away in talent-rich but low-cost India. Infosys dubbed its approach the "global delivery model."

Infosys's rapid rise is legendary in India. In the 1980s the company was just a small group of programmers who had traveled from South Asia to the United States to offer their services. But in the early 1990s India's rapid deregulation and the rise of the internet opened the door for the global delivery model. Today Infosys is a $5 billion IT services firm with more than 100,000 employees and a market cap of nearly $40 billion.

During the late 1990s, with revenues growing rapidly, Infosys could easily have focused on preservation. But Murthy was intent on challenging the biggest companies in the IT services industry, including IBM and Accenture. He and then-CEO Nandan Nilekani had a hypothesis about how the industry would evolve. The company's most demanding clients were frustrated by having to work simultaneously with multiple services firms, each lacking full accountability. Eventually, Murthy and Nilekani believed, clients would hire just one firm that could deliver end-to-end IT services. The hypothetical company would provide a management consulting team that would redesign operations and write specifications for new IT systems. That same company would then develop, test, install, and maintain the new hardware and software—and might even accept responsibility for executing routine client operations such as transaction processing.

This implied a dramatic industry transformation. If multiple rivals moved toward end-to-end services, former partners would become rivals. The industry would have room for only a handful of very large players. Infosys intended to be one of them—and to use its mastery of the global delivery model to outperform rivals. To accomplish that, the company needed to create several new services even as it continued executing its existing, fast-growing business. By pushing into boxes 2 and 3, Infosys grew 25-fold, from $200 million to $5 billion in the past decade. Revenues from services other than its original offering—custom software development—grew from a small base in the 1990s, to 40% by 2003, and to nearly 60% by 2010.

Infosys succeeded in avoiding the box 2 hazard of organizational memory. By building a parallel "box 2/3" world with different people and distinct processes, it was able to create the future while sustaining excellence in box 1. In the process, Infosys paid especially close attention to three critical disciplines: strategy making, accountability, and organizational design.

Strategy Making

The central tenets of strategy making are well known. It should be an analytical, data-driven process that rigorously identifies customer needs, differentiates the company from rivals, and maximizes profits. But despite its many merits, this process also systematically squeezes out box 3 thinking. Leaders who insist on rigorously analyzed data tend to resist making change on the basis of limited evidence or weak signals. The result: a short-term mind-set; a strict focus on existing customers, not emerging ones; an obsession with today's rivals, not potential entrants; an emphasis on leveraging existing competencies rather than building new ones; and a tacit assumption that lines of demarcation between markets are fixed.

Box 3 strategy making is very different. Endeavors of creation must begin with a destructive (box 2) action—abandoning traditional strategy practices in favor of new ones. Box 3 strategy is not about linear extrapolation from the past; it's about trying to anticipate nonlinear shifts. That's a tough—but necessary—concept to grasp if you're a senior leader who rose to the top of an organization by excelling in box 1.

Infosys smartly brought nontraditional voices into the box 3 strategy process. For example, it di-

Thirty percent of participants in any strategy discussion should be younger than age 30, because they are not wedded to the past.

rectly engaged a subset of its clients, in group and one-on-one meetings, to challenge the company's long-range assumptions and to make provocative suggestions for future growth. As a direct result of this interaction, Infosys chose to redouble its investment in an experimental business unit that offered packaged software for Indian bank branches—and to adapt it for worldwide use.

Infosys relied even more heavily on input from young employees. It assembled a Voices of Youth panel of high performers who participated annually in eight senior management meetings. In putting together this team, Murthy cited what he calls the "30/30 rule": 30% of participants in any strategy discussion should be younger than age 30, because they are creative and not wedded to the past. In addition, Infosys created several inventive and colorfully named mechanisms—strategy graffiti walls, knowledge cafés, jam sessions, and speed-geeking—to continually attract thousands of young employees to the process. Jam sessions, for instance, are fast-paced roundtable meetings in which each participant has just one minute to give an impromptu response to questions such as "How can Infosys win in emerging markets?" The company even developed software that automated the process of sifting through huge volumes of responses, to identify common themes and unique ideas. Murthy credits youth involvement for sparking more than 10 R&D projects at Infosys, on topics ranging from health care to sustainability to education.

Accountability

To succeed at preservation (box 1), successful companies develop mechanisms that hold individuals accountable for results. Those who deliver on time, on budget, and on spec should earn raises and promotions; those who don't are probably better suited for other careers. Companies with demanding performance cultures, such as GE, tend to do very well in box 1. But, again, initiatives to create the future must begin by forgetting the past. Strict accountability for results must be left behind to allow for conjectures about potential nonlinear shifts. Those conjectures are best tested by running disciplined experiments.

For example, in 1999 IBM launched an effort to multiply computing speeds by a factor of 500. IBM's conjecture was that the next generation of supercomputers would not run on one super-fast chip but on huge networks of ordinary chips. IBM's machine, dubbed BlueGene, would, as imagined, run massive simulations for scientists who study climate change, particle physics, cellular processes, and more. The big unknown, however, was the relationship between the number of chips and the volume of communications among them. It was possible that the network that tied the chips together would clog up like Los Angeles freeways at rush hour. To pinpoint when that would happen, IBM developed a systematic test plan. It first built a prototype with just two chips, then four, then eight. It ran disciplined experiments with each prototype. If BlueGene were to fail, IBM would learn at the lowest cost possible. By 2007 the company had succeeded in building a 212,992-chip BlueGene, the fastest supercomputer in the world.

When leaders of box 3 initiatives learn fast (and at minimal cost), they make better decisions. They either find success or exit quickly and cheaply. But disciplined experimentation is not easy. As we describe in our book *The Other Side of Innovation,* best practices for planning experiments look almost nothing like best practices for ongoing operations. Therefore, it's critical to use distinct methods to evaluate the results of box 3 initiatives and the performance of their leaders.

Consider the negative consequences of subjecting a leader to a traditional, results-focused performance assessment while she operates in box 3. Uncertainties are high, and assumptions often prove wrong, yielding disappointing results and leaders who get defensive about them. Open discussion disappears, learning ceases, and bad decision making tends to ensue. Instead, leaders should be held accountable for learning quickly from disciplined experiments that they conduct in box 3. Administered properly, this form of accountability is anything but forgiving. It requires intense reasoning and ruthless analysis of assumptions.

Infosys has developed a very strong culture of accountability for results. In fact, it created an acronym

for its expectations of business unit leaders' actions—namely, that they be predictable, sustainable, profitable, and de-risked: PSPD. Still, Infosys maintains different kinds of expectations for new services—standards that allow for greater uncertainty but are no less forgiving.

In 2002 Infosys launched a fundamentally new (box 3) business for the company: Infosys Consulting. Instead of producing custom software, the new consulting unit would advise clients on redesigning their operations; rather than calling on heads of IT, it would serve general managers. The core business of software programming was almost a science, whereas Infosys Consulting was more of an art.

Murthy and Nilekani knew it was unrealistic to expect its new service to immediately deliver predictable, sustainable, profitable, and de-risked results. So they exempted it from traditional performance review forums and had it report to an internal board of directors. That board looked for clear signs that Infosys Consulting was headed toward success. For example, it expected an upward trend in per-employee revenues as time dedicated to selling services declined and time dedicated to delivering services rose. The board also altered expectations about forecast accuracy for Infosys Consulting: not 99%, as required of established units, but 50%, at least at first. As the team learned, its forecasts naturally improved.

Organizational Design

To achieve day-to-day excellence (box 1), companies must do more than hire and train outstanding individuals. They must optimize the way individuals collaborate—through job specifications, organizational designs, and work processes. When all individuals are perfectly aligned, companies become works of high art. However, a box 1 work of art is also a highly specialized machine. As such, it's unrealistic to expect to be able to just "squeeze in" a box 3 project. Special teams are essential. The first step in building them is a box 2 action—dropping standard organizational practices. Box 3 projects require zero-based, custom-built subunits.

Forming these subunits is an act of creation even more significant than generating a breakthrough box 3 idea. As we explained in "Stop the Innovation Wars" (HBR July–August 2010), it's much like building a new company from scratch. Outsiders play a critical role by bringing in new skills and catalyzing change. They are powerful box 2 agents because they naturally challenge assumptions.

The High Jump "Industry"

The history of the Olympic high jump event illustrates the importance of adapting to nonlinear change. It has evolved through four distinct "business models."

Early on, the "scissors" style dominated the sport. It was much like hurdling. All high jumpers used the scissors approach, so winning meant being the best at it. The high jumpers were operating in box 1 (preservation). Had they been businesspeople, they would have been competing on cost, market share, and margins.

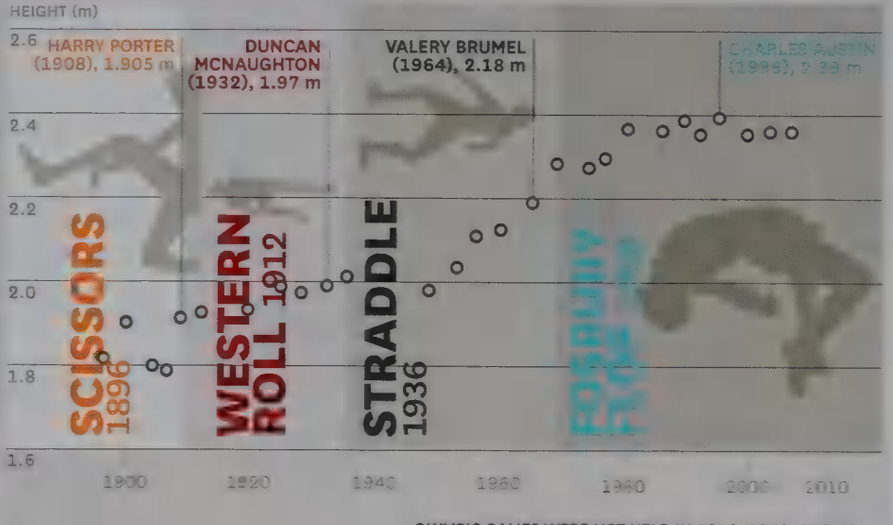
High jumpers remained in box 1 at their peril, however. Even the best athletes could improve upon the established technique only incrementally. The approach had severe limitations because the jumper's center of gravity had to rise much higher than the bar.

More-innovative jumpers broke the high jump down into two fundamentals: raising one's center of gravity (jumping higher) and raising it no more than necessary to clear the bar (avoiding "wasted lift"). It turned out that although finding ways to jump higher was quite difficult, athletes could find plenty of opportunities to avoid wasted lift. High jumpers created three new styles.

First, they invented the "western roll," in which jumpers launched and landed on the same foot and kept their backs to the bar. Then they discovered the "straddle," in which they launched and landed on opposite feet and faced the bar. Finally, in the 1968 Olympics, Dick Fosbury created the surprising Fosbury Flop, which required twisting 180 degrees and landing on one's head. To succeed, Fosbury had to unlearn everything his coaches had taught him about speed, angle of approach, and technique.

Each new jumping style transformed the high jump "industry." The innovators had to somehow forget best practices (box 2) and create next practices (box 3). Many other jumpers, trapped by the forces of preservation (box 1), failed to remain competitive.

OLYMPIC GOLD MEDAL WINNERS IN HIGH JUMP



OLYMPIC GAMES WERE NOT HELD IN 1916, 1940, AND 1944.

The Transformation Process in Hindu Mythology

Hinduism provides a unique window into the three perspectives we focus on in this article: managing the present, selectively forgetting the past, and creating the future. The religion recognizes many gods but only three main deities: Vishnu, the god of preservation (box 1); Shiva, the god of destruction (box 2); and Brahma, the god of creation (box 3).

The Hindu mythmakers even paired each of the three gods with symbolically relevant wives. Vishnu was married to Lakshmi, who bestowed wealth—just as box 1 produces current income. Shiva's partner was Parvathi, who symbolized power, a vital box 2 necessity when selectively destroying the past. Brahma was betrothed to Saraswathi, who symbolized creativity, ideas, and knowledge—critical inputs in formulating box 3 strategies.

According to Hindu philosophy, the balanced interactions among the three gods create a continuous preservation–destruction–creation cycle that helps sustain all forms of life in a circle without a beginning or an end. Achieving that continuous cycle is a goal worthy of any farsighted organization.

Infosys Consulting was a box 3 project, so Murthy and Nilekani created a new, distinct subunit. They hired an outsider with 15 years of consulting experience to lead the effort, and they lured several more senior partners from other consulting firms. Then, rather than creating a unit based on Infosys's existing organizational structure, they studied other firms' processes and organizational designs and altered them for the global delivery model. Today Infosys Consulting generates more than $100 million in revenues annually.

That's a much more favorable outcome than what happened when one of the Big Three U.S. automakers first entered India in the early 1990s. The tremendous economic divide between India and the United States demanded a box 3 approach to making an automobile. Rather than creating a zero-based subunit in India to spearhead the effort, however, the company engineered the car in Detroit and, to cut costs, decided to put power windows only in the front doors. That decision initially seemed reasonable, but at that time any Indian who could afford a car could also afford a chauffeur. The owner, sitting in the back, had to use hand-crank windows. It's one reason why this U.S. automaker is still largely irrelevant in one of the world's fastest-growing automotive markets.

Prioritizing for the Long Term

As we have discussed, the secret to winning over the long run lies in knowing what to forget and what to create. Still, every box 3 initiative requires a tough first step: making the commitment to launch. Shifting resources from the present to the future may be the most difficult challenge for CEOs, given the enormous short-term pressures they face routinely.

In its early days, Infosys had a *Fortune* 10 client that accounted for 25% of its revenues and was demanding substantial price concessions. Murthy walked away and accepted a devastating blow to short-term performance. His simple rationale: Infosys would never agree to a price so low that it would have to sacrifice service quality or cut investments in people, training, R&D, and technology. Doing so, he reasoned, would damage the brand and undermine the company's future.

The most intense short-term pressures come not from clients, however, but from Wall Street, which demands reliable earnings growth and richly rewards CEOs who deliver it. This powerful box 1 incentive cripples the forces of destruction and creation because box 3 projects inevitably have a worse-before-better impact on the bottom line. Further, CEOs' tenures are short relative to the rhythm of transformation efforts. By the time box 3 projects pay off, many will have retired, so they are tempted to focus on the immediate and leave on a high note.

Murthy, by contrast, views Infosys as a lifelong endeavor. His approach to investors has been steadfast: Relentlessly promote long-term potential; immediately share short-term disappointment. Murthy volunteered the bad news of the loss of the major client to investors within 48 hours. Then he returned to finding the right balance among the forces of preservation, destruction, and creation. This balance is the secret to Infosys's mastery of both the present and the future, and it must be the foundation for any business institution that aspires to endure for generations.

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EQUAL HOUSING LENDER

Hitachi's Commitment to Social Innovation



TADAHIKO ISHIGAKI, Senior Vice President and Executive Officer, Chief Executive for the Americas, Hitachi, Ltd.

How has social innovation become a key part of Hitachi's growth strategy? Why?

We believe that creating a safe and secure social infrastructure with limited environmental impact is part of the solution to answering some of the most challenging issues facing our global society today. Given Hitachi's expertise in infrastructure development and information technology, Hitachi is uniquely positioned to provide solutions to these challenges by offering products and services developed from fusing technologies in these areas. Over the next three years, we plan to invest approximately $12 billion and spend $7 billion on R&D expenses related specifically to the growth of social innovation business.

Tell us about the business lines that make up the social innovation portfolio at Hitachi.

Hitachi's diverse business portfolio includes information and telecommunication systems; power systems; and industrial, transportation and urban development systems; and the key devices and materials that support them.

How would you describe the key drivers for Hitachi's business in the Americas?

We are focusing on clean energy, information technologies, and green mobility. In terms of clean energy, our key business drivers are nuclear power plants and ultra-supercritical thermal power plants. We also have developed air quality control systems that comply with U.S. environmental regulations.

Additionally, we are collaborating with Sask Power, a Canadian power corporation, on a project relating to low-carbon energy technologies. In the nuclear power plant business, we have an established global nuclear alliance with General Electric. This joint venture, GE-Hitachi Nuclear Energy, affords us the opportunity to provide safe, sustainable nuclear energy to the U.S.

For information technologies, we do business in storage solutions globally and command a top share of the global market in this ever-growing and competitive enterprise sector. This is the result of the capabilities of Silicon Valley-based Hitachi Data Systems (www.hds.com), which is the leader in storage virtualization. Also, Hitachi Consulting (www.hitachiconsulting.com), our cutting-edge consultancy business, is a recognized leader in developing solutions for Fortune 1000 customers in the most challenging areas of sustainability management today. In green mobility, we are developing lithium-ion batteries for hybrid and electric cars, and we provide our lithium-ion batteries to carmakers worldwide.

Can you provide a "big picture" of some of the recent achievements in the social innovation business?

In relation to our R&D investment, Hitachi, Ltd., and Johnson Controls, Inc., will work together on several fronts in the field of advanced energy storage as part of a recent Memorandum of Understanding. They will study opportunities for collaboration in the fields of motive and non-motive advanced energy storage including lithium-ion batteries.

Hitachi Power Systems America, Ltd. (www.hitachipowersystems.us), was recently awarded a 10-year contract by the New York Power Authority for replacing and modifying major components of Lewiston Pump Generating Plant's pump-turbine units.

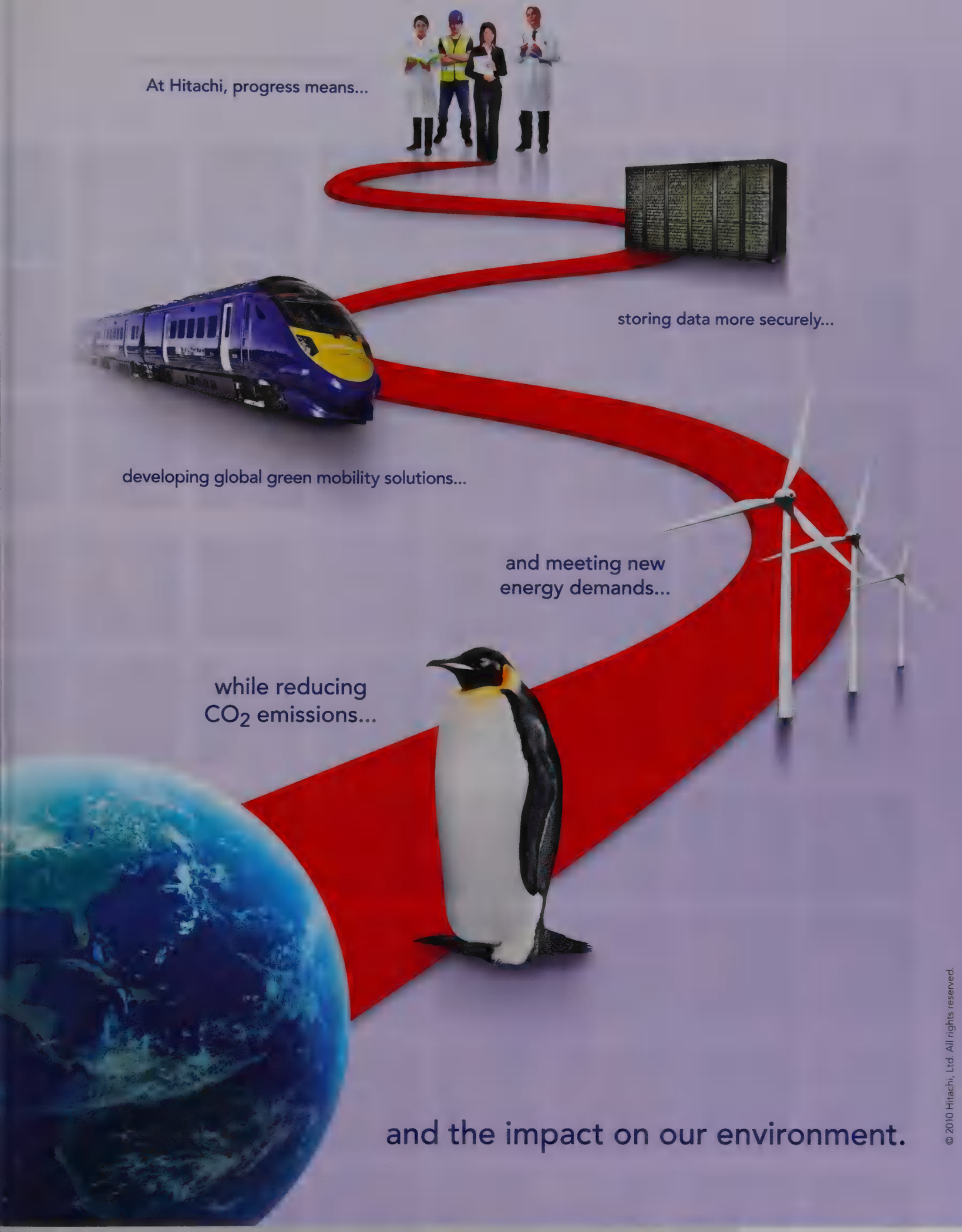
We acquired software assets relating to next-generation mobile communication systems from Nortel Networks, a Canadian network company, in December 2009 and have had a partnership with L-1 Identity Solutions, an American biometric authentication company, since November 2009 to strengthen these businesses. Also, we collaborated with Avion on the Finger Vein Authentication system and provided the system to law enforcement in Jackson County, Alabama.

We were awarded a contract from General Motors to produce lithium-ion batteries for GM's future hybrid vehicles. Additionally, Hitachi Metals (www.hitachi-metals.co.jp/e/index.html) recently acquired the Mass Flow Controller business from Advanced Energy Industries, Inc.

So you believe that the company will "do well by doing good?" How will you measure success?

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The HBR Interview



VIDEO To watch a video of the full interview, go to **bigthink.com.**

"What Is It That Only I Can Do?"

HE'S BEEN A GROCER AND A CEO FOR 32 YEARS NOW. Lately, Whole Foods Market cofounder and co-CEO John Mackey, with his controversial utterances on health care reform and climate change, has been in the news as much for what he says as for what he sells. But in this edited interview with HBR's Justin Fox, conducted in collaboration with the online video forum Big Think, Mackey talks about what makes a corporation run.

HBR: You recently announced that you were committed to staying at Whole Foods Market for another 10 years. What brought that on?

Mackey: The announcement came when we made the decision to promote Walter Robb to co-CEO. That, combined with the fact that I stopped being the chairman of the board in December 2009, led to speculation that I might be leaving the company. So I thought it was important to announce that I'm not phasing out.

You had thought about having three co-CEOs.

Yes, because we function as equals on our team. People make the same compensation, except for me—I donate it all. We tend to make decisions by consensus. We don't have a three-to-two vote. It's not the Supreme Court trying to work things out. We really want to reach consensus, and we respect each other. In a sense we could have had five co-CEOs. But A.C. Gallo and Walter Robb were the copresidents and co-COOs, so we decided that Walter would take the title of co-CEO and A.C. would be the sole president and chief operating officer. That seemed to make everybody happy.

Has this emphasis on consensus been there from the very beginning, or has it evolved over the years?

It has evolved over the years. I found that when you make decisions by consensus, and you let all the disagreements get expressed, you make better decisions. If you don't do that, there is a natural human tendency on the part of whoever didn't get their way to

want to be proved right. It's like "See, I told you that wasn't going to work."

Does it sometimes take a long time to reach consensus?

It can. Generally, if you're making decisions that really are going to impact the business, it's good to talk them over. It's a little bit like Japanese management decision making—they spend a lot more time trying to develop consensus in the decision group. The virtue of it is that although it takes longer to make the decision, implementation goes a lot faster, because there isn't resistance or sabotage that works its way through the organization.

What you call conscious capitalism—is that part of it, or is that just a management style?

That is a management style.



You have to create a conscious culture— a culture that allows the organization to fulfill its higher purpose.

What is conscious capitalism?

First, you have to understand the basic principles that help capitalism flourish. One is property rights. You need the ability to trade your property, and to trade it to pretty much whomever you want. Another is the rule of law—laws and regulations that are well understood so that you can factor them into your business decisions. The rule of law has to be applied equally to everyone. For example, if Whole Foods goes into a city and is told our cheese has to be refrigerated, it's fundamentally unjust if that rule isn't applied to our competitors as well—which, I might add, does sometimes happen in New York City. You also need to have conscious businesses—that is, businesses that become conscious of their higher purpose, which is not just about maximizing profits and shareholder value.

Second, you have to recognize the stakeholder model: Customers, employees, investors, suppliers, larger communities, and the environment are all interdependent. You operate the business in such a way that it's not a zero-sum game.

Third, you need what we call conscious leadership. You could also call it servant leadership. Leaders identify their own flourishing with the flourishing of the organization. They're trying to serve the organization and its purpose.

Fourth, you have to create a conscious culture—a culture that allows the organization to fulfill its higher purpose, implements the stakeholder model, and enables conscious leadership to flourish.

So, what are the core principles of Whole Foods, and where do they come from?

I think business enterprises are like any other communities. They can aspire to the highest values that have inspired humans throughout time. You can use different value models, but I like Plato's the good, the true, and the beautiful. Add the heroic to that—meaning changing and improving the world and standing up for what you believe is true and right and good. I think Whole Foods' highest purpose is a heroic one: to try to change and improve our world. That is what animates me personally. That is what animates the company. I resisted that purpose for a long time, by the way. I actually thought we were in some variant of service—that it was really about fulfilling the good. The team members consistently told me I was wrong, that we had a different purpose. It was this more heroic purpose.

In terms of the age-old debate about whether companies exist for the shareholders or for something else, is there one group? Is it customers? Is it employees? Or is it this purpose?

That gets back to the second principle of conscious capitalism—the stakeholder model. I think it's kind of deep in human nature to think in terms of the zero sum. If one stakeholder is winning, someone else must be losing. It comes from sports, where there is one winner and lots of losers, and this idea of a fixed pie, where if someone is getting a bigger piece, someone else has to be getting a smaller piece, and what's needed for social justice is to make sure people get equal pieces. But a conscious business recognizes that you can have an expanding pie, and potentially everyone can get a larger piece.



I'll give you a simple example: Management's job at Whole Foods is to make sure that we hire good people, that they are well trained, and that they flourish in the workplace, because we found that when people are really happy in their jobs, they provide much higher degrees of service to the customers. Happy team members result in happy customers. Happy customers do more business with you. They become advocates for your enterprise, which results in happy investors. That is a win, win, win, win strategy. You can expand it to include your suppliers and the communities where you do business, which are tied in to this prosperity circle. A metaphor I like is the spiral, which tends to move upward but doesn't move in a straight line.

In 2008 and 2009 a lot of people thought that they weren't moving forward. How did Whole Foods handle that?

We did take a couple of steps backward. But we saw it as an opportunity to refocus on how to create more value for our customers. We did that in two ways. One was to look at our prices more carefully. We're quite aware that we're lampooned and criticized for being too expensive. So we've focused on trying to get our prices down, and we think we've done a good job of that. The other way was to create more quality differentiation. We looked at all the areas of our store—meat, seafood, prepared foods, bakery, grocery—and asked how we could differentiate ourselves by giving customers a better experience or better quality. So we worked on it from both ends, and as the economy has begun to improve, our company has jumped out in front. We've been growing very rapidly again for the past few quarters.

Did any specific product or process surprise you and move the company forward in a big way?

I would say that we've done a few things that were very interesting. On the price side, for example, one of our strongest competitors is Trader Joe's. Trader Joe's does a really good job in its wine selection. It has a lot of inexpensive wines, including the famous Two-Buck Chuck. We've come out with our own wine, called Three Wishes, which matches Two-Buck Chuck in price. We think it's a higher-quality wine, judging from blind taste tests. We've introduced it just in the past couple of months, and it's doing amazingly well. That's an example of how we are trying to get less-expensive products into our stores.

We've also done some differentiation: We've announced our seafood sustainability initiative. We want to have transparency on each of the species we sell in our seafood departments, so we're working with the Blue Ocean Institute and the Monterey Bay Aquarium. If you look in our seafood cases, you can see that each species has been rated according to their standards. Combine that with our commitment to the Marine Stewardship Council, and we think we've got a good sustainability initiative, which our customers appreciate.

Has that limited the kinds of seafood you're able to sell?

It has, and it will limit them a bit more in the future, because we're going to gradually phase out any species that have been given a red rating, meaning that they're least sustainable. You're either committed to sustainability or you're not. You either do it or you don't. Sometimes that means you do things that might hurt you in the short term but will underscore your integrity as an organization, which ultimately proves to be valuable in competing with companies that maybe have less commitment to that type of integrity.

Where Whole Foods (and John Mackey) Came From

After he dropped out of the University of Texas, John Mackey moved into a vegetarian co-op in Austin in 1977 because he thought he would "meet some interesting women." He became the co-op's food buyer, went to work at a natural-foods store, and then, in 1978, joined forces with his girlfriend to start their own store, Safer Way Natural Foods. In 1980 Safer Way merged with a competitor to become Whole Foods, one of the country's first natural-foods supermarkets.

Thirty years and 15 acquisitions later, Whole Foods dominates natural-foods retailing in the United States and has become an iconic brand. It is expanding in the United Kingdom as well, and its purchasing standards and priorities shape agricultural practices around the world. The company is still based in Austin and still run by the quirky, outspoken Mackey—although he has shared the chief executive's job since May 2010 with his longtime lieutenant Walter Robb.

Mackey's outspokenness occasionally lands him in trouble. In 2007 the "Rahodeb" incident, in which Mackey was revealed to have been writing feisty pseudonymous posts (Rahodeb is an anagram of his wife's name) on a stock message board for seven years, resulted in an SEC investigation. In 2009 he wrote an op-ed for the *Wall Street Journal* decrying government involvement in health care, which led to outraged protests from some Whole Foods customers (although, Mackey points out, it didn't hurt sales). But he heads a corporation that runs about as smoothly as such a fast-growing enterprise possibly could, empowers its employees and pays them well, and offers customers a panoply of healthful and sustainably raised food. "Conscious capitalism," Mackey calls it.

HBR's pages are full of discussions about how sustainability is becoming a competitive advantage. Do you believe that?

I do think sustainability is a way to compete. I don't think it's the most important way. I see it as more of a niche. It reflects the consciousness of your customers, and the truth is that most customers don't care about it. Most customers at the end of the day care mostly about price. That consciousness is still dominant out there. But there is a growing consciousness about things like environmental sustainability and animal welfare. When we started out, 30 years ago, organic was a niche, and most people didn't know what it was. But I would say that partly because of Whole Foods' success, organic is now very much in the national consciousness.

More recently, Whole Foods has gotten behind the emphasis on local agriculture and has helped to popularize it. Wal-Mart is beginning to pay attention to this also, so in a lot of ways Whole Foods is helping to evolve the agricultural system in the United States.

You had an interesting back-and-forth with Michael Pollan a few years ago, when he criticized you and Whole Foods. What was your evolution through that process?

Well, I think Michael took some unfair pokes at Whole Foods in his book *The Omnivore's Dilemma*. He did his four meals in that book, and for three of them he did a lot of research. For the fourth meal, from Whole Foods, he didn't talk to anybody at the company. He didn't dive deeper. He just did his own personal investigation in the stores, and therefore I think he got a lot of things wrong. When I read his book, of course I wasn't very happy about how Whole Foods was portrayed, and I began a dialogue with him. We ended up in a debate in Berkeley, California, back in February 2007, and a couple of thousand people showed up. That was a healthy exchange. And to give Michael credit, I think certain parts of his criticism ended up being true. Whole Foods wasn't doing enough to promote local agriculture. We were not doing enough to promote, for example, grass-fed beef. We had put way too much emphasis on organic and not enough on some of these other aspects, and it was good that Michael called us to task. That kind of criticism stings, but there was also an opportunity there. I actually think you should engage your critics and see them, too, as stakeholders who are helping you to improve.

What's the division of labor for you and the rest of the executive team back in Austin? Are you spending all your time writing op-eds?

I've written one op-ed in 32 years.

I guess you write about one blog post every two months?

More like two a year. My job has evolved steadily over the years. I've always asked myself this question: "What is it that only I can do?" If somebody else can do it, then maybe it's not the best job for me. That has caused me to give up many things that I really liked doing and was really good at. I'm up in New York right now. I'm going to go to a Morgan Stanley conference, talk to investors. I'm going to talk to media.

I tour our stores a lot. For right or wrong, good or bad, I am seen as sort of the father of the company, so the team members really like it when I come into their stores. They want to meet me. They want to have their picture taken with me. So I've found that it's very good for morale for me to go to the stores and just walk around meeting people. That is not something I really enjoy doing or am particularly good at. I'm actually more of an introvert than an extrovert. But through constant practice I've gotten a lot better at it.

I talk to suppliers, so in a sense I'm also probably still the major strategist for the company. I'm very creative, so a lot of initiatives—from seafood sustainability to animal welfare to healthy eating—have come up through me. I don't worry too much about the day-to-day operations of the company. I'm more of a big-picture guy.

If you're talking to somebody who is starting a company or trying to grow one, do you have any pearls of wisdom?

I think it's important that you get some idea of what your purpose is—why you're doing what you're doing. I actually don't think trying to maximize profits is a very good long-term strategy for a business. It doesn't inspire the people who work for you. It doesn't lead to that higher creativity.

Was there some point early in Whole Foods' growth when you had to step back and ask, "What is our purpose?"

The interesting thing about our purpose is that it has continued to evolve. As a company grows, its purpose grows with it.

Let me give you an example. We've always tried to be good citizens in the communities where we do business. We originally thought of that as meaning we would support not-for-profit organizations there. But then we asked the question, "Do we have any responsibility in the developing nations where we're trading, where we buy our coffee, where we get our bananas?" The answer was yes. We began to work with Muhammad Yunus, of Grameen Bank, who won the Nobel Peace Prize in 2006 for microcredit loans in Bangladesh. We worked with him and with Grameen replicators, and we are now in 23 countries. Through the Whole Planet Foundation, we've set up microlending organizations in the communities we're actually trading in.

If you take a very narrow sort of Milton Friedman view that the only social responsibility of business is to maximize profits, what we did looks like theft from the shareholders. We're taking their money and giving it away in loans to developing-world poor people. But nothing we've ever done in our history has created more goodwill with our team members than that.

We now have a program where our team members can volunteer to go work in some of the communities where we're doing microlending. We have what we call a prosperity campaign, in which our customers make small donations at the cash registers. We raise a couple of million dollars a year that way and funnel it into microcredit, so the customers are now engaged in it. Our suppliers get preferential marketing callouts in our stores if they're part of our microcredit alliance, so they are benefiting. Rather than take a narrow win-lose view, we've built goodwill with our customers, goodwill with our team members, goodwill with our suppliers, and, we believe, higher profits for our shareholders. The foundation has actually created shareholder value, because of these complex feedback loops.

Final question: Thirty years from now, what will Whole Foods look like? What will its purpose look like?

I don't play that game any longer. It's really hard to predict more than a few years out. I can prove that by just saying that nobody Googled anything 13 years ago because Google didn't exist. Nobody had an iPod nine years ago, and nobody had an iPhone five years ago, and nobody was on Facebook seven years ago. The world changes. They weren't doing Big Think six years ago. So I don't really have a clue what Whole Foods is going to look like in 30 years. But I sure as heck hope we're still following a higher purpose, we're still using the stakeholder philosophy, and we're still for conscious businesses that attempt to fulfill a heroic purpose in the world. If we're doing that and we haven't lost our way, I think the business will continue to flourish. I'll be 87 years old. One thing I can pretty confidently predict is that I won't still be in charge of Whole Foods in 30 years. If I am, then look out, because I'll be a pretty crotchety old man at 87.

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FOR FURTHER READING

More about Whole Foods and alternatives to shareholder capitalism:

Firms of Endearment: How World-Class Companies Profit from Passion and Purpose
by Rajendra S. Sisodia, David B. Wolfe, and Jagdish N. Sheth
(Wharton School Publishing, 2007)

Be the Solution: How Entrepreneurs and Conscious Capitalists Can Solve All the World's Problems
by Michael Strong
(Wiley, 2009)

Employees First, Customers Second: Turning Conventional Management Upside Down
by Vineet Nayar
(Harvard Business Review Press, 2010)

"Rethinking the Social Responsibility of Business"
by Milton Friedman, John Mackey, and T.J. Rodgers
Reason, October 2005
http://s.hbr.org/9nanbq

"The Whole Foods Alternative to ObamaCare"
by John Mackey
Wall Street Journal
August 11, 2009
http://s.hbr.org/cyMc5y

"The Age of Customer Capitalism"
by Roger Martin
Harvard Business Review
January–February 2010
http://s.hbr.org/9SfxyK

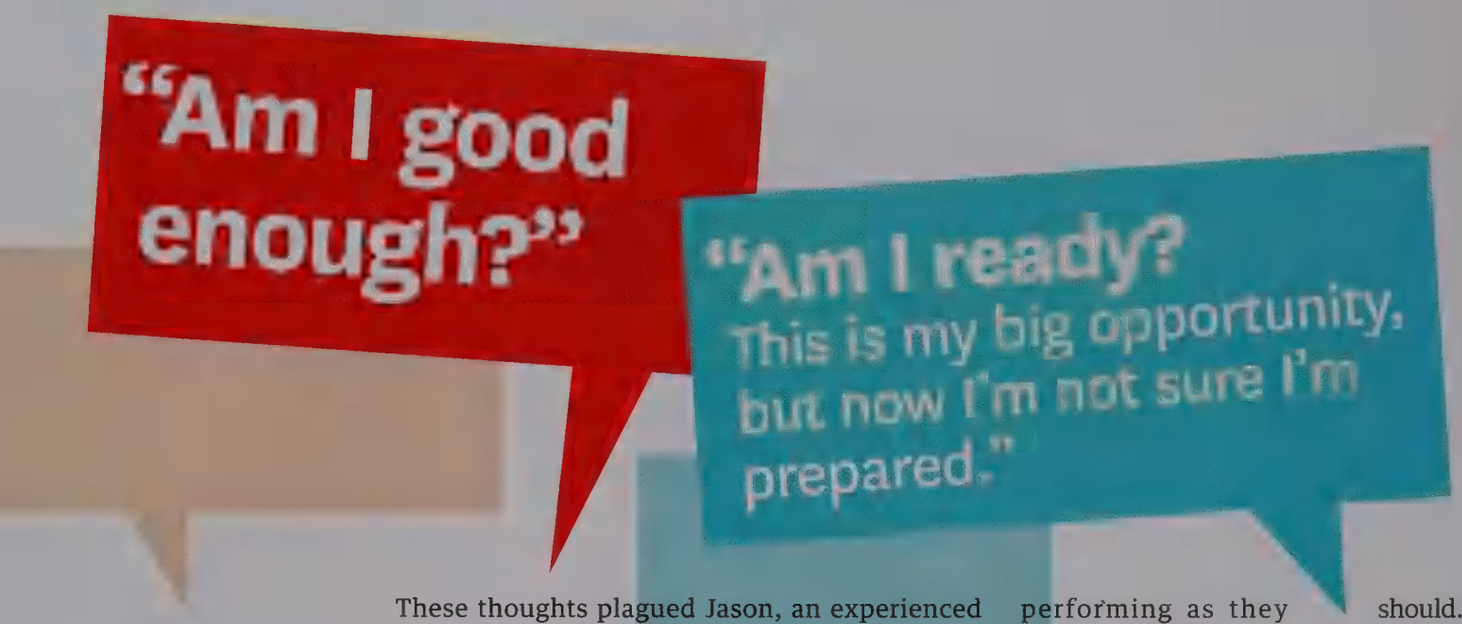
I actually don't think trying to maximize profits is a very good long-term strategy for a business. It doesn't inspire the people who work for you.



Are You A Good Boss— Or a Great One?

If you want to keep growing as a leader, ask yourself these key questions.

by Linda A. Hill and Kent Lineback



These thoughts plagued Jason, an experienced manager, as he lay awake one night fretting about a new position he'd taken. For more than five years he had run a small team of developers in Boston. They produced two highly successful lines of engineering textbooks for the education publishing arm of a major media conglomerate. On the strength of his reputation as a great manager of product development, he'd been chosen by the company to take over an online technical-education start-up based in London.

Jason arrived at his new office on a Monday morning, excited and confident, but by the end of his first week he was beginning to wonder whether he was up to the challenge. In his previous work he had led people who'd worked together before and required coordination but little supervision. There were problems, of course, but nothing like what he'd discovered in this new venture. Key members of his group barely talked to one another. Other publishers in the company, whose materials and collaboration he desperately needed, angrily viewed his new group as competition. The goals he'd been set seemed impossible—the group was about to miss some early milestones—and a crucial partnership with an outside organization had been badly, perhaps irretrievably, damaged. On top of all that, his boss, who was located in New York, offered little help. "That's why you're there" was the typical response whenever Jason described a problem. By Friday he was worried about living up to the expectations implied in that response.

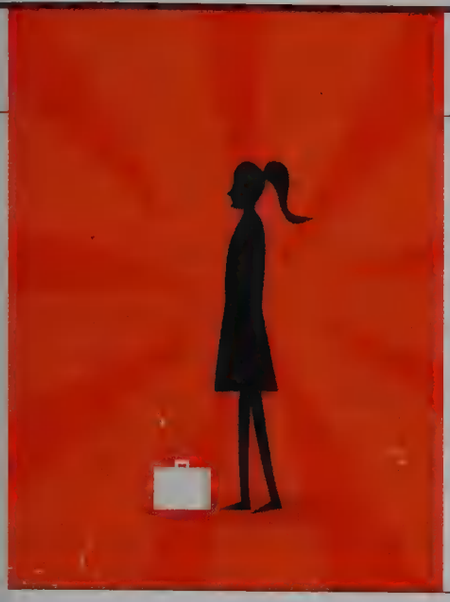
Do Jason's feelings sound familiar? Such moments of doubt and even fear may and often do come despite years of management experience. Any number of events can trigger them: An initiative you're running isn't going as expected. Your people aren't performing as they should. You hear talk in the group that "the real problem here is lack of leadership." You think you're doing fine until you, like Jason, receive a daunting new assignment. You're given a lukewarm performance review. Or one day you simply realize that you're no longer growing and advancing—you're stuck.

Most Managers Stop Working on Themselves

The whole question of how managers grow and advance is one we've studied, thought about, and lived with for years. As a professor working with high potentials, MBAs, and executives from around the globe, Linda meets people who want to contribute to their organizations and build fulfilling careers. As an executive, Kent has worked with managers at all levels of both private and public organizations. All our experience brings us to a simple but troubling observation: Most bosses reach a certain level of proficiency and stop there—short of what they could and should be.

We've discussed this observation with countless colleagues, who almost without exception have seen what we see: Organizations usually have a few great managers, some capable ones, a horde of mediocre ones, some poor ones, and some awful ones. The great majority of people we work with are well-intentioned, smart, accomplished individuals. Many progress and fulfill their ambitions. But too many derail and fail to live up to their potential. Why? Because they stop working on themselves.

Managers rarely ask themselves, "How good am I?" and "Do I need to be better?" unless they're shocked into it. When did *you* last ask those questions? On the spectrum of great to awful bosses, where do you fall?



Idea in Brief

Many managers underestimate the transformational challenges of their roles—or they become complacent and stop growing and improving. At best they learn to get by; at worst they become terrible bosses. Sometimes even the best of them suffer doubts and fears despite years of management experience.

Three imperatives can guide managers on their journey to becoming great bosses: (1) *Manage yourself.* Productive influence comes from people's trust in your competence and character. (2) *Manage your network.* The organization as a whole must be engaged to create the conditions for your own and your team's success. (3) *Manage your team.* Effective managers forge a high-performing "we" out of all the individuals who report to them.

Constant and probing self-assessment across these three imperatives is essential, the authors write. They include a useful assessment tool to help readers get started.

Managers in new assignments usually start out receptive to change. The more talented and ambitious ones choose stretch assignments, knowing that they'll have much to learn at first. But as they settle in and lose their fear of imminent failure, they often grow complacent. Every organization has its ways of doing things—policies, standard practices, and unspoken guidelines, such as "promote by seniority" and "avoid conflict." Once they're learned, managers often use them to get by—to "manage" in the worst sense of the word.

It doesn't help that a majority of the organizations we see offer their managers minimal support and rarely press the experienced ones to improve. Few expect more of their leaders than short-term results, which by themselves don't necessarily indicate real management skill.

In our experience, however, the real culprit is neither managerial complacency nor organizational failure: It is a lack of understanding. When bosses are questioned, it's clear that many of them have stopped making progress because they simply *don't know how to.*

Do you understand what's required to become truly effective? Too often managers underestimate how much time and effort it takes to keep growing and developing. Becoming a great boss is a lengthy, difficult process of learning and change, driven mostly by personal experience. Indeed, so much time and effort are required that you can think of the process as a journey—a journey of years.

What makes the journey especially arduous is that the lessons involved cannot be taught. Leadership is using yourself as an instrument to get things done in the organization, so it is about self-development. There are no secrets and few shortcuts. You and every other manager must learn the lessons yourself, based on your own experience as a boss. If you don't understand the nature of the journey, you're more likely to pause or lose hope and tell yourself, "I can't do this" or "I'm good enough already."

Do you understand what you're trying to attain? We all know how disorganized, fragmented, and even chaotic every manager's workdays are. Given this reality, which is intensifying as work and organizations become more complex and fluid, how can you as a boss do anything more than cope with what comes at you day by day?

To deal with the chaos, you need a clear underlying sense of what's important and where you and your group want to be in the future. You need a mental model that you can lay over the chaos and into which you can fit all the messy pieces as they come at you. This way of thinking begins with a straightforward definition: Management is responsibility for the performance of a group of people.

It's a simple idea, yet putting it into practice is difficult, because management is *defined* by responsibility but *done* by exerting influence. To influence others you must make a difference not only in what they do but also in the thoughts and feelings that drive their actions. How do you actually do this?

To answer that question, you need an overarching, integrated way of thinking about your work as a manager. We offer an approach based on studies of management practice, our own observations, and our knowledge of where managers tend to go wrong. We call it the *three imperatives:* Manage yourself. Manage your network. Manage your team.

Is this the only way to describe management? No, of course not. But it's clear, straightforward, and, above all, focused on what managers must actually do. People typically think of "management" as just the third imperative, but today all three are critical to success. Together they encompass the crucial activities that effective managers must perform to influence others. Mastering them is the purpose of your journey.



Manage Yourself

Management begins with you, because who you are as a person, what you think and feel, the beliefs and values that drive your actions, and especially how you connect with others all matter to the people you must influence. Every day those people examine every interaction with you, your every word and deed, to uncover your intentions. They ask themselves, "Can I trust this person?" How hard they work, their level of personal commitment, their willingness to accept your influence, will depend in large part on the qualities they see in you. And their perceptions will determine the answer to this fundamental question every manager must ask: Am I someone who can influence others productively?

> Trust is the foundation of all forms of influence other than coercion. You need to foster it.

Who you are shows up most clearly in the relationships you form with others, especially those for whom you're responsible. It's easy to get those crucial relationships wrong. Effective managers possess the self-awareness and self-management required to get them right.

José, a department head, told us of two managers who worked for him in the marketing department of a large maker of durable goods. Both managers were struggling to deliver the results expected of their groups. Both, it turned out, were creating dysfunctional relationships. One was frankly ambivalent about being "the boss" and hated it when people referred to him that way. He wanted to be liked, so he tried to build close personal relationships. He would say, in effect, "Do what I ask because we're friends." That worked for a while until, for good reasons, he had to turn down one "friend" for promotion and deny another one a bonus. Naturally, those people felt betrayed, and their dissatisfaction began to poison the feelings of everyone else in the group.

The other manager took the opposite approach. With her it was all business. No small talk or reaching out to people as people. For her, results mattered, and she'd been made the boss because she was the one who knew what needed to be done; it was the job of her people to execute. Not surprisingly, her message was always "Do what I say because I'm the boss." She was effective—until people began leaving.

If productive influence doesn't arise from being liked ("I'm your friend!") or from fear ("I'm the boss!"), where does it come from? From people's trust in you as a manager. That trust has two components: belief in your *competence* (you know what to do and how to do it) and belief in your *character* (your motives are good and you want your people to do well).

Trust is the foundation of all forms of influence other than coercion, and you need to conduct yourself with others in ways that foster it. Management really does begin with who you are as a person.

Manage Your Network

We once talked to Kim, the head of a software company division, just as he was leaving a meeting of a task force consisting of his peers. He had proposed a new way of handling interdivisional sales, which he believed would increase revenue by encouraging each division to cross-sell other divisions' products. At the meeting he'd made an extremely well-researched, carefully reasoned, and even compelling case for his proposal—which the group rejected with very little discussion. "How many of these people did you talk to about your proposal before the meeting?" we asked. None, it turned out. "But I anticipated all their questions and objections," he protested, adding with some bitterness, "It's just politics. If they can't see what's good for the company and them, I can't help them."

Many managers resist the need to operate effectively in their organizations' political environments. They consider politics dysfunctional—a sign the organization is broken—and don't realize that it unavoidably arises from three features inherent in all organizations: *division of labor,* which creates disparate groups with disparate and even conflicting goals and priorities; *interdependence,* which means that none of those groups can do their work without the others; and *scarce resources,* for which groups necessarily compete. Obviously, some organizations handle the politics better than others, but conflict and competition among groups are inevitable. How do they get resolved? Through organizational influence. Groups whose managers have influence tend to get what they need; other groups don't.

Unfortunately, many managers deal with conflict by trying to avoid it. "I hate company politics!" they

say. "Just let me do my job." But effective managers know they cannot turn away. Instead, with integrity and for good ends, they proactively engage the organization to create the conditions for their success. They build and nurture a broad network of ongoing relationships with those they need and those who need them; that is how they influence people over whom they have no formal authority. They also take responsibility for making their boss, a key member of their network, a source of influence on their behalf.

Manage Your Team

As a manager, Wei worked closely with each of her people, who were spread across the U.S. and the Far East. But she rarely called a virtual group meeting, and only once had her group met face-to-face. "In my experience," she told us, "meetings online or in person are usually a waste of time. Some people do all the yakking, others stay silent, and not much gets done. It's a lot more efficient for me to work with each person and arrange for them to coordinate when that's necessary." It turned out, though, that she was spending all her time "coordinating," which included a great deal of conflict mediation. People under her seemed to be constantly at odds, vying for the scarce resources they needed to achieve their disparate goals and complaining about what others were or were not doing.

Too many managers overlook the possibilities of creating a real team and managing their people as a whole. They don't realize that managing one-on-one is just not the same as managing a group and that they can influence individual behavior much more effectively through the group, because most of us are social creatures who want to fit in and be accepted as part of the team. How do you make the people who work for you, whether on a project or permanently, into a real team—a group of people who are mutually committed to a common purpose and the goals related to that purpose?



Effective managers know that even in a cohesive team they cannot ignore individual members.

To do collective work that requires varied skills, experience, and knowledge, teams are more creative and productive than groups of individuals who merely cooperate. In a real team, members hold themselves and one another jointly accountable. They share a genuine conviction that they will succeed or fail together. A clear and compelling purpose, and concrete goals and plans based on that purpose, are critical. Without them no group will coalesce into a real team.

Team culture is equally important. Members need to know what's required of them collectively and individually; what the team's values, norms, and standards are; how members are expected to work together (what kind of conflict is acceptable or unacceptable, for example); and how they should communicate. It's your job to make sure they have all this crucial knowledge.

Effective managers also know that even in a cohesive team they cannot ignore individual members. Every person wants to be a valued member of a group *and* needs individual recognition. You must be able to provide the attention members need, but always in the context of the team.

And finally, effective managers know how to lead a team through the work it does day after day—including the unplanned problems and opportunities that frequently arise—to make progress toward achieving their own and the team's goals.

Be Clear on How You're Doing

The three imperatives will help you influence both those who work for you and those who don't. Most important, they provide a clear and actionable road map for your journey. You must master them to become a fully effective manager.

These imperatives are not simply distinct managerial competencies. They are tightly integrated activities, each of which depends on the others. Getting your person-to-person relationships right is critical to building a well-functioning team and giving its individual members the attention they need. A compelling team purpose, bolstered by clear goals and plans, is the foundation for a strong network, and a network is indispensable for reaching your team's goals.

Knowing where you're going is only the first half of what's required. You also need to know at all times where you are on your journey and what you must do to make progress. We're all aware that the higher you rise in an organization, the less feedback you get about your performance. You have to be prepared to regularly assess yourself.

Measuring Yourself on the Three Imperatives

Are you performing all the activities necessary to be an effective boss? To get some sense of where you stand, assess yourself on the following questions:

		I NEED TO MAKE PROGRESS				THIS IS A STRENGTH
MANAGE YOURSELF						
1. Do you use your formal authority effectively?	**THIS IS A STRENGTH IF** you consider it a useful tool but not your primary means of influencing others. You make clear why you do what you do—and even share your authority with others when possible and appropriate. You focus more on the responsibilities that come with authority than on the personal privileges it provides.	1	2	3	4	5
2. Do you create thoughtful but not overly personal relationships?	**THIS IS A STRENGTH IF** your relationships are rich in human connections but always focused on the purpose and goals of the team and the organization. You avoid trying to influence people by befriending them.	1	2	3	4	5
3. Do others trust you as a manager?	**THIS IS A STRENGTH IF** people, particularly your own, believe in your competence, intentions, and values. You demonstrate concern for their individual success.	1	2	3	4	5
4. Do you exercise your influence ethically?	**THIS IS A STRENGTH IF** you consistently identify stakeholders, weigh their interests, and try to mitigate any harm that your actions may cause as you attempt to accomplish a greater good.	1	2	3	4	5
MANAGE YOUR NETWORK						
5. Do you systematically identify those who should be in your network?	**THIS IS A STRENGTH IF** you are always aware of which people and groups you and your team depend on, and vice versa, as circumstances change.	1	2	3	4	5
6. Do you proactively build and maintain your network?	**THIS IS A STRENGTH IF** you create and sustain relationships with those in your network, connect frequently with them, and support their needs.	1	2	3	4	5
7. Do you use your network to provide the protection and resources your team needs?	**THIS IS A STRENGTH IF** you protect your team from distractions and misunderstandings, use your network to solve problems inside and outside the team, and secure the funds, people, and other resources it needs.	1	2	3	4	5
8. Do you use your network to accomplish your team's goals?	**THIS IS A STRENGTH IF** you form coalitions of network members to support your team's goals and help others in your network achieve theirs. Your network colleagues believe in your competence and character.	1	2	3	4	5
MANAGE YOUR TEAM						
9. Do you define and constantly refine your team's vision for the future?	**THIS IS A STRENGTH IF** you've defined your team's purpose and the goals, strategies, and actions that will take you there. You constantly gather information, discuss your plans with others, and refine your ideas.	1	2	3	4	5
10. Do you clarify roles, work rules, team culture, and feedback about performance for your team?	**THIS IS A STRENGTH IF** your people feel a strong sense of "we"—that they're all pulling together toward the same worthwhile goals. They know how they individually contribute and what the team's work involves. They receive regular feedback from you.	1	2	3	4	5
11. Do you know and manage your people as individuals as well as team members?	**THIS IS A STRENGTH IF** you interact equitably with all team members individually. You delegate, strive to help people grow, and constantly assess their performance. You hire people who both fit the team and add diversity, and you deal with performance issues quickly.	1	2	3	4	5
12. Do you use daily activities and problems to pursue the three imperatives?	**THIS IS A STRENGTH IF** you regularly consider how every problem, obligation, or event can help you build your team, make progress on its goals, develop people, and strengthen your network.	1	2	3	4	5

HOW DID YOU DO? Did your responses cover the whole range from 1 to 5? If you consistently assessed yourself at 3 or above, you should be skeptical. In our experience, few bosses merit high ratings across the board. Did you give yourself mostly 3s? Take care not to hide in the middle, telling yourself, "I'm OK—not great, but not failing either." And don't be satisfied to stay there. "I'm not failing" is the watchword of those who are comfortable—and stuck.



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Too many managers seem to assume that development happens automatically. They have only a vague sense of the goal and of where they stand in relation to it. They tell themselves, "I'm doing all right" or "As I take on more challenges, I'll get better." Consequently, those managers fall short. There's no substitute for routinely taking a look at yourself and how you're doing. (The exhibit "Measuring Yourself on the Three Imperatives" will help you do this.)

Don't be discouraged if you find several areas in which you could do better. No manager will meet all the standards implicit in the three imperatives. The goal is not perfection. It's developing the strengths you need for success and compensating for any fatal shortcomings. Look at your strengths and weaknesses in the context of your organization. What knowledge and skills does it—or will it—need to reach its goals? How can your strengths help it move forward? Given its needs and priorities, what weaknesses must you address right away? The answers become your personal learning goals.

What You Can Do Right Now

Progress will come only from your work experience: from trying and learning, observing and interacting with others, experimenting, and sometimes pushing yourself beyond the bounds of comfort—and then assessing yourself on the three imperatives again and again. Above all, take responsibility for your own development; ultimately, all development is self-development.

You won't make progress unless you consciously act. Before you started a business, you would draw up a business plan broken into manageable steps with milestones; do the same as you think about your journey. Set personal goals. Solicit feedback from others. Take advantage of company training programs. Create a network of trusted advisers, including role models and mentors. Use your strengths to seek out developmental experiences. We know you've heard all this advice before, and it is good advice. But what we find most effective is building the learning into your daily work.

For this purpose we offer a simple approach we call *prep, do, review.*

Prep. Begin each morning with a quick preview of the coming day's events. For each one, ask yourself how you can use it to develop as a manager and in particular how you can work on your specific learning goals. Consider delegating a task you would normally take on yourself and think about how you might do that—to whom, what questions you should ask, what boundaries or limits you should set, what preliminary coaching you might provide. Apply the same thinking during the day when a problem comes up unexpectedly. Before taking any action, step back and consider how it might help you become better. Stretch yourself. If you don't move outside familiar patterns and practice new approaches, you're unlikely to learn.

Do. Take whatever action is required in your daily work, and as you do, use the new and different approaches you planned. Don't lose your resolve. For example, if you tend to cut off conflict in a meeting, even constructive conflict, force yourself to hold back so that disagreement can be expressed and worked through. Step in only if the discussion becomes personal or points of view are being stifled. The ideas that emerge may lead you to a better outcome.

Review. After the action, examine what you did and how it turned out. This is where learning actually occurs. Reflection is critical, and it works best if you make it a regular practice. For example, set aside time toward the end of each day—perhaps on your commute home. Which actions worked well? What might you have done differently? Replay conversations. Compare what you did with what you might have done if you were the manager you aspire to be. Where did you disappoint yourself, and how did that happen? Did you practice any new behaviors or otherwise make progress on your journey?

Some managers keep notes about how they spent their time, along with thoughts about what they learned. One CEO working on a corporate globalization strategy told us he'd started recording every Friday his reflections about the past week. Within six weeks, he said, he'd developed greater discipline to say no to anything "not on the critical path," which gave him time to spend with key regulators and to jump-start the strategy.

If you still need to make progress on your journey, that should spur you to action, not discourage you. You can become what you want and need to be. But you must take personal responsibility for mastering the three imperatives and assessing where you are now.

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How to Make the Most of Your Company's Strategy

The art of translating top management's aspirations into concrete action on the ground *by Stephen Bungay*



Stephen Bungay (mail@stephenbungay.com) is a director of the Ashridge Strategic Management Centre and the author of *The Art of Action: How Leaders Close the Gaps Between Plans, Actions and Results* (Nicholas Brealey Publishing, 2011), on which this article is based.

In the decades since Peter Drucker first urged executives to manage by objectives, companies have replaced his famous "letter to the boss" with ever more elaborate and time-consuming processes for setting goals. The result is usually a profusion of measures and targets, finally approved six months into the year they are supposed to cover, that only add to the confusion about what really matters to the business. For most managers, the big unanswered question remains: What do you want *me* to do?

This article is about how to answer that question. In the following pages you will read about a process I call strategy briefing, a technique derived from the military. Through it, managers and their reports can move together from the uncertainty surrounding seemingly complex goals and performance measures to clarity about just which objectives each person needs to focus on, in what order of priority. The briefing also helps managers set parameters for two variables that are the bedrock of high performance: the extent to which people in an organization act in line with its leaders' intentions, and how much freedom they have to take independent action.

In essence, the briefing turns lofty strategic goals into a clear blueprint for execution.

In what follows I'll walk you through the five-step briefing process, illustrating it with a fictional example stitched together from my own experiences as a consultant and a teacher. To conclude I'll explain how to roll the process up, down, and across your organization.

The Road to Confusion Is Paved With Good Intentions

Joe was a star. An engineer, he also had an MBA and worked at a large, well-established information services company. A year after moving into product development, he was asked to set up a low-cost R&D center in Asia. By introducing new, less expensive offerings, the company hoped to fend off increasing competition from cheaper rivals.

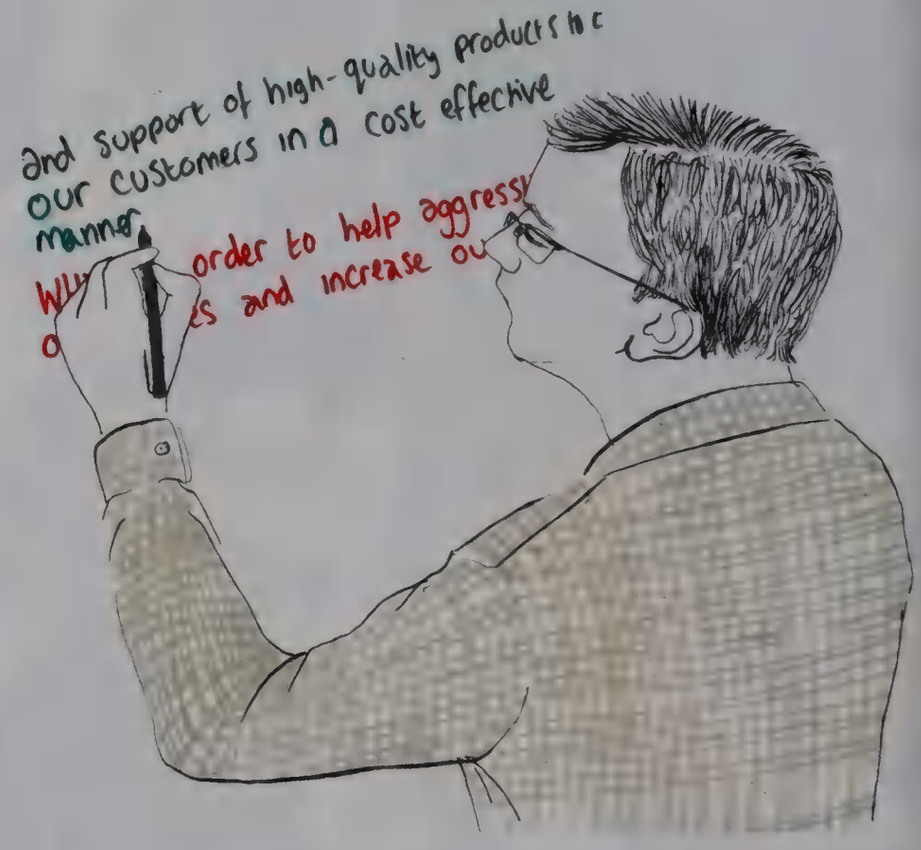
Six months into the project, Joe convened an offsite. After presenting the company's goals and challenges, he asked the people attending for thoughts on how they could help meet them. After a few moments' silence, one of the senior technicians raised his hand. "I don't want to sound negative," he said, "but what exactly are we really trying to achieve?"

Joe was taken aback. "It's perfectly clear, isn't it? We're creating a new center to develop low-cost products. We've got two years. You know the situation, and you know the company's strategy. I just went through it."

"Sure," came the reply, "but frankly, I'm still confused. There's lots of stuff in our goals about shareholder value, reinventing ourselves, thinking globally, and embracing change. There's stuff about being innovative and delivering superior customer satisfaction, and there are targets for increasing revenue, lowering costs, and raising margins. Well, I don't get it. From where I sit the sky's falling in. We're in a deep recession, the competition is eating our lunch, revenues are falling, margins are shot to bits, customers are starting to hate us, and all anyone seems to care about is getting rid of people to save money. Some of us are probably next. Where are we in all this? What are we supposed to do?"

Joe sensed that he needed to take control. "OK," he said, "I hear you. And you're right. Let's sit down and work it out now so we're all singing from the same sheet. Let's not just talk; let's write it down, so we all know exactly what we are about."

STEP 1
State Your Intent



Joe went over to a flip chart and wrote down "Task + Purpose." Under "Task" he wrote "what," and under "Purpose" he wrote "why." As he turned back to his audience, he saw to his surprise that people had perked up. "So we'll answer those questions, right?" he said. "Here and now."

The discussion began as usual with an aspiration. It was not long before the words "world class" were uttered, as someone suggested that the team's purpose was to "build a world-class development facility." Some of the team members liked that. Others rolled their eyes. "Look," somebody piped up, "that's an aspiration anyone could have. It makes no difference; it's vague and has nothing to do with our situation." The first version was crossed out. The purpose became "To build a new development facility."

"But that's just a description of what we're doing," came the objection. "Isn't the question, What are we trying to achieve?"

"We need to reduce costs," came the answer. So perhaps that was the "why."

THE TAKEAWAY

Joe began by trying to define what his group's intent was, essentially drafting a statement outlining what the people above him expected his group to do and why. If you were a soldier, you'd recognize this intent as your mission. Getting to the right statement is not easy; it took Joe and his team several tries. But a clearly defined intent unifies a team's effort. Before the off-site, Joe's people had been generating a lot of activity. Once they had agreed upon the statement, they could see which activities supported the intent and stop the rest. That produced a degree of calm in his overworked department.

Idea in Brief

Managers struggle to translate corporate strategy into what they should actually be doing. How can that challenge be addressed? Through strategy briefing, a five-step approach to planning that originated with the military. It provides a way for managers and their reports to move together from confusion around a complex set of goals and measures to clarity around just which objectives each person needs to focus on and when.

The steps are (1) state your intent, or what you are expected to do and why, (2) revise it in the context of your company's situation, (3) determine which measures best indicate whether you're achieving your goal, (4) define the tasks implied by your intent, and (5) define the boundaries, or constraints, that limit your team.

The process is repeated throughout the organization, with the tasks formulated by a group becoming the intents of the groups below them. In this way, a strategy is broken down into a cascade of discrete but linked elements that align the organization.

Joe called a halt to the increasingly fractious discussion. "Let's step back a second," he suggested. "What is the situation?" He tried to sum it up, for both himself and the others:

"The company's revenues are declining by 10% a year, in part because we're in the worst market in history but also because we're losing share. Our cost base is 30% too high, our products are old, and customer satisfaction is falling. We claim to be innovative, but new-product development is blocked. Our job, surely, is to unblock it. If we do that, it will reduce operating costs and improve customer satisfaction, and that will help sales."

Joe felt somewhat liberated by what he had just said. Like everyone else, he had a mental list of what needed to be done. The company always had to improve costs, revenues, margins, and service. But he had just articulated the relationship between them for the first time. New-product development was the link that completed the chain. He realized that for him success meant getting products out now.

The discussion continued. Half an hour later, the group had its first answer on the flip chart:

What: To significantly reduce time to market for development, enhancements, and support of high-quality products to our customers in a cost-effective manner.

Why: In order to help aggressively grow our revenues and increase our margins.

During lunch Joe went outside to think. He did not like what the team had written. It was too broad and too unrealistic. How was the firm going to aggressively grow in the current market? He ruefully realized that he should have thought about this long ago. He needed to set the scene for his people.

STEP 2

Try Again—This Time in Context

Joe went back to the flip chart and turned down a new sheet. At the top of it he wrote, "Context." Then he listed four observations:

1. The company's market share is being eroded by competitors under some of the most difficult trading conditions in our history.
2. The loss of share must be halted, or we will have no basis for future growth.
3. Customer service is the key to halting this decline, but with the existing product line, it's impossible to deliver outstanding service at acceptable margins.
4. With the current loss of accounts, every day that passes makes recovery more difficult.

The group came back in as he finished. "Does that help?" he asked. There were nods as people read what he had written. "Actually, we've got a crucial role in all of this, haven't we?" observed one of the head programmers.

"And," somebody added, "if it's true, it means that what matters is time. We've got to speed things up."

"Is that right?" someone else asked. "Is that what the company wants us to do?"

"Let's look again at what the company strategy document says," Joe replied. He fiddled around on his laptop until the words of the corporation filled the screen:

We are committed to delivering Great Service to our customers. This will require us to build a strong service-based culture. This will be achieved by a combination of improved customer and market

THE TAKEAWAY

Before a group can arrive at the right statement of intent, its leader needs to set a context. Context setting requires understanding the goals and constraints of both the people above you and the people above them. Going two levels up helps you to see how your own actions fit into the bigger picture and to determine your priorities. Keep in mind that revisions are critical to the briefing process. Progress is made only through an iterative process of formulation, critique, and readjustment.

"If we give ourselves a target we can't achieve," Joe said, "we're setting ourselves up for failure."

segmentation capability, improved customer service processes and tools, and, significantly, specific customer-focused behaviors' being constantly demonstrated both internally and with external customers. The goal is to reshape the business to deliver superior shareholder value over a sustained period.

The group stared blankly at the screen. "Marketing wrote that," someone commented.

"More like HR," said another person. "Though finance finally got their oar in at the end."

"Think about what's behind it," Joe said. "It says there is going to be a change. The clock's ticking. We have to give customers better service than our competitors do if we are to get them back, and we've got to make money as well."

"So how do we fit in?" someone asked.

"If the company is to compete on service, it needs us to come up with the products to enable it to do so," Joe replied. "It used to be all about technology and features, but it's a service game now. I was talking to the head of technology about it. He wants a coherent suite of products, not the mess we've got now, with different offerings for every region and every client. I've talked to the head of Asia as well. The costs are killing us. We have to make some hard choices. Sales won't like it, but there it is. It is our call. Why don't we try to write it down, simply, and work out what it is that senior management wants us to do? What was their intention when they wrote all this?"

Forty minutes and several flip-chart sheets later, Joe's group had a formulation, which it decided to call "Higher Intent." The formulation read:

TWO LEVELS UP (CORPORATE)

What: To transform the company within the next three years.

Why: In order to deliver superior service and financial performance.

ONE LEVEL UP (TECHNOLOGY GROUP)

What: To develop and support a coherent product line that is easy to service.

Why: In order to allow sales and marketing to grow revenues.

"Our job," said Joe, "is to fulfill the technology group's intent in Asia. Their intent tells us a few things that should drive every decision. The new products have to be simpler to service, or they're no good. They have to fit in with what's being done globally, and the local salespeople will have to live with that—no more customization. We've got to design products with sales and marketing to make sure they'll sell. They have to be low cost or we can't make money. And we've got to move fast. Now let's look at our earlier intent statement again. What do *we* have to do *now*?"

The immediate needs were defensive. There was no way anyone could grow revenues and margins in the current climate. The firm had to stop the erosion of market share. It was also clear that the company had to get something new out the door that year. Moreover, Joe's group needed to focus its efforts; more than 250 products, in all stages, were in the pipeline, and the group would have to decide which ones would make the most difference.

Finally, the team came up with this statement of intent:

What: To accelerate delivery of critical products to market.

Why: In order to enable sales channels to halt market share erosion by year-end.

"Is this ambitious enough?" someone asked. "It doesn't sound particularly inspiring."

"This is enough," said Joe. "If we give ourselves a target we can't achieve, we're setting ourselves up for failure. But that reminds me, we need some measures so that we know what we're doing is working. We haven't finished yet."

STEP 3
Set Your Measures

Joe and his team determined that to achieve the objectives they had just outlined, they needed to focus on three things—time, market share, and costs. They expressed each in terms of a goal:

1. Deliver agreed product set by year-end and on budget.
2. See that total market share in Asia at the end of the year equals the share at the beginning of the year.
3. Reduce operating costs for development in the region by 20%.

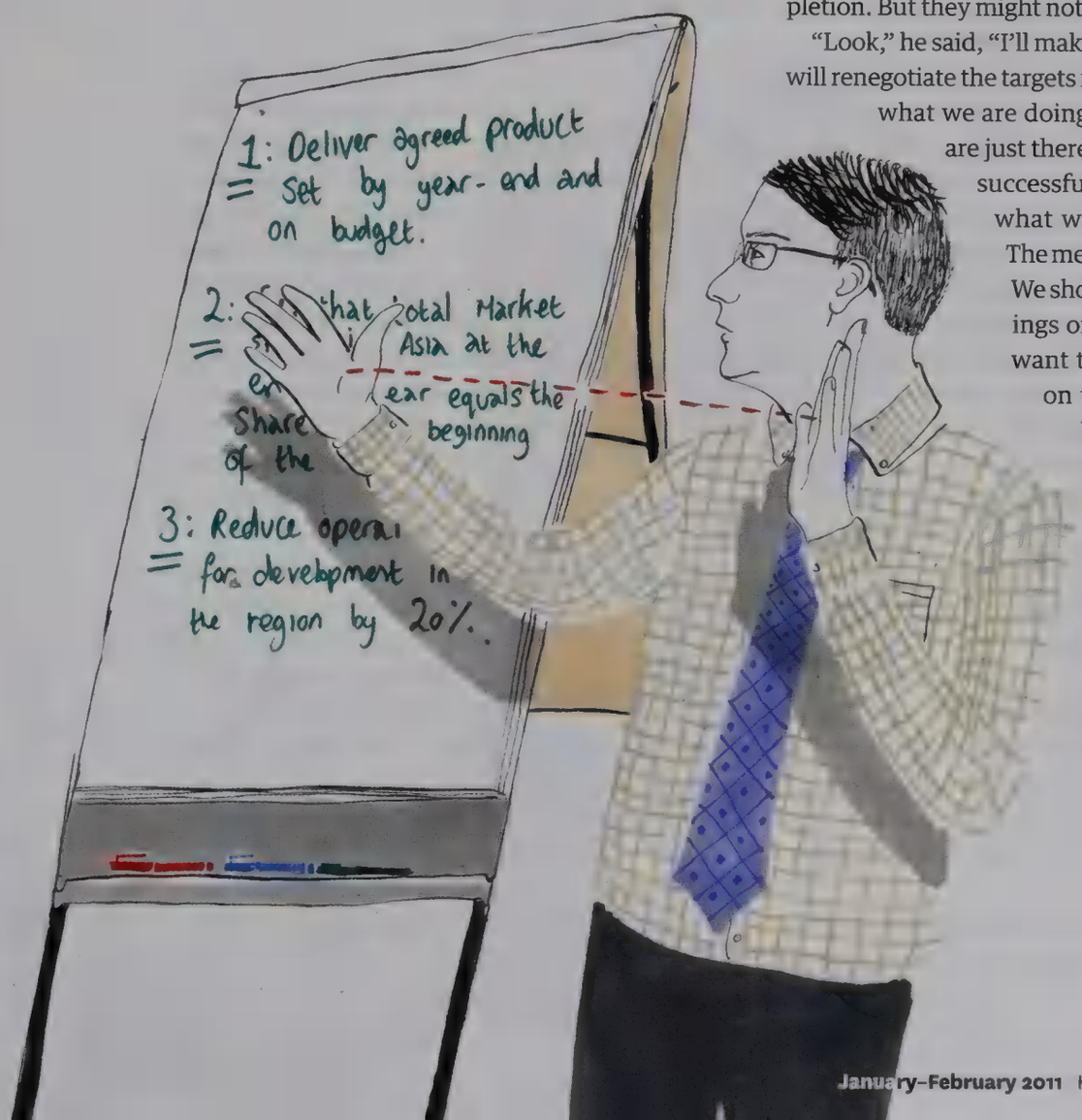
THE TAKEAWAY
You need measures to monitor whether or not you're achieving your intent. Sometimes, if your briefing is going well, you'll find that the activities you see as most appropriate to your intent aren't the ones you are actually assessed on. If that's the case, it becomes the responsibility of the team leader to go back to the people above him or her and negotiate new performance measures, as Joe decides to do here.

There was a pause. They were all studying the flip chart. Someone frowned. "We ourselves cannot stop market share from declining," he said. "Do we want to be measured on that?"

"Strictly speaking, no," replied Joe, "but it is the purpose behind everything we are doing. If the rate at which we're losing share goes down, we'll know what we're doing is working, even if we don't hit the target. If we don't look at it, we might be barking up the wrong tree."

"What about what we *are* measured on?" someone piped up. "We've all got targets. Dozens of them." So they had, including Joe himself. Part of his bonus was tied to the number of new products delivered. Optimizing that would not be difficult—he could just go for the easy development projects nearest completion. But they might not have the most impact.

"Look," he said, "I'll make a commitment to you. I will renegotiate the targets for this group. I'll explain what we are doing and that the measures are just there to tell us whether we're successful or not. The outcome is what we're trying to optimize. The measures are the dashboard. We should not confuse the readings on it with what we really want to do, which is to arrive on time at our destination. When we've worked out who is doing what, I'll measure your performance on how well you accomplish your assigned tasks. What I want to know from you now is what you think those tasks should be."





STEP 4

Define the Tasks Implied By Your Intent

The people in Joe's group started by looking at what they were actually doing. They were involved in three types of activity: growing an offshore facility, improving costs and efficiency, and working on various initiatives related to morale and customer service. They decided to do only what was essential and to sideline initiatives not related to their intent.

Then they realized they'd left something out. Someone needed to figure out which products were critical to the company's goals—an issue no one was addressing. That was the first task. The team members knew that some work on costs would have to continue but that it was even more important to speed up development and deliver something good to the sales force. To ensure that people didn't get distracted from that task, they decided to dedicate half the staff solely to development and have the rest work only on enhancements and support. In sum, four main tasks were implied by the intent:

1. Identify the critical products.
2. Accelerate development of those products.
3. Create enhancements to existing products faster and provide more-responsive product support.
4. Reduce costs.

If Joe and his group accomplished all those goals, they would achieve their intent—and be heroes. But suppose they had to make trade-offs? Joe looked at the list. "In all of this," he asked, "what's really vital? If we had to cut, where would we cut last?"

The team members had a debate. Though they needed to define the critical products, they could get that broadly right. They had to reduce costs, but if they failed, they could accept low margins for a time. The thing that mattered most was the fast development of new products—if they didn't get that right this year, all else would be in vain. Joe went back to the chart and drew a red circle around "Accelerate development." Next to it, he wrote, "Main effort."

It was time for a break. Joe went for a stroll outside and reflected. The group had started with a list of things to do that were only loosely related and varied in importance. Putting that to one side, the participants had thought through what needed to be done most so that the tasks were prioritized. They had filled in a key missing piece in their to-do list—identifying the critical products. And they also had a list of tasks that didn't overlap, so people could tackle them without getting in one another's way. Now Joe wanted to assign the tasks to his people and have them come up with a plan for accomplishing them. He didn't want to dictate how to do things; his reports all knew their jobs better than he did and needed to put some creative thought into their plans. He wanted to give them space. But how could he set the right parameters for them?

Joe went back in, and as the team reassembled, he wrote a new heading on each of two flip charts: "Freedoms" and "Constraints." The brainstorming began. A quarter of an hour later, the list under "Freedoms" included "senior management support," "motivated employees," and "the importance of new products." A longer list under "Constraints" included "concerns about our ability to deliver," "customer reluctance to adopt new products," "competitor activity," and "organizational complexity."

THE TAKEAWAY

Your next job is to prioritize the tasks that you've decided will help you meet your intent. Joe identified his highest priority, or "main effort," as accelerating development, because it would have the largest impact on the company's overall intent of halting the decline in market share. That meant that if he lost people midyear because of head-count reductions, he would transfer engineers working on product enhancement and support into development so that market introductions would not be delayed.



STEP 5

Define the Boundaries

Joe stepped back. Everyone looked a bit blank. The lists weren't very helpful. They looked like a list of good things and a list of bad things. The bad ones were more complaints than constraints, plus a few worries. The lists didn't show what people were or were not free to do.

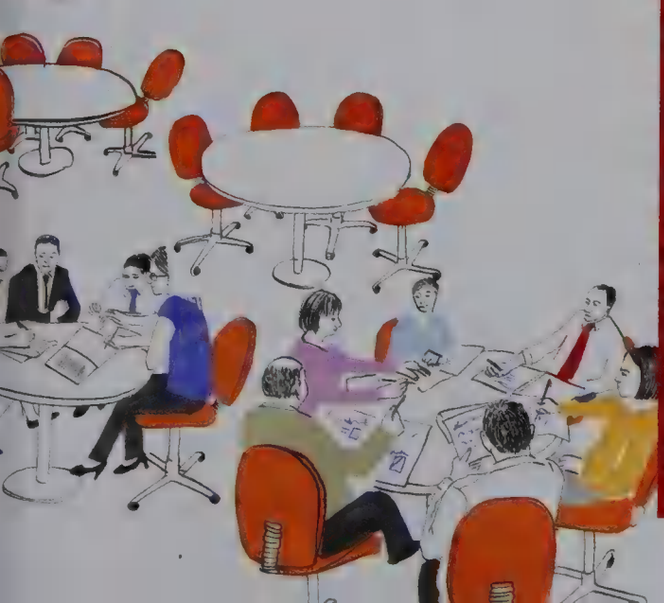
"Let's try again," he said. "Let's really try to think about what we can or can't do. Let's begin with the constraints."

It soon became clear that there were two big ones: They were trying to optimize time, but cost and quality imposed boundaries. Within a few minutes there was an earnest debate among the participants, which started to get passionate and technical at the same time. Joe stopped it. "We've just identified another aspect of the tasks," he said. "We're going to have to work this out as we go. Let's not assume we know the answer already." He wrote down the two constraints:

1. Product quality—to be defined with reference to customer needs and the service organization.
2. Product cost—requirements set by budget and competitive benchmarks.

THE TAKEAWAY

To execute a strategy, employees need to be able to adapt as the situation changes. Boundaries give them the freedom to do that. That sounds paradoxical, but in my experience, if they're not given boundaries, people create more rigid ones for themselves. In the process, they tend to list things that are getting in their way or might go wrong. Those are not boundaries but difficulties we want them to overcome. A boundary puts limits on possible alternative objectives. In Joe's case, time, cost, and quality were all potential objectives. But he could optimize only one, time. Thus, the others became constraints, or boundaries. He could do whatever he wanted to optimize time subject to achieving minimum standards for cost and quality.



Though Joe's group had no control over those constraints, it had to find out what they were. He and his team realized that by defining their boundaries, they were also identifying whom they had to talk to both inside and outside the organization. The discussion became more concrete and more focused. They identified two more constraints and a question:

3. The requirement to reduce the number of development centers—to be agreed on with the head of Asia.
4. Product obsolescence program—to be agreed on with global product management.
5. Who has final decision on new-product development projects?

As he looked at these, Joe realized that he had defined his own role. His job as leader was to manage the team's boundaries. Tackling the first four constraints would involve working with the decision makers and ensuring that the team's proposals were good enough to be accepted. The fifth item on the list was something he had to clarify. He made a note to himself to raise the issues with both his regional boss and his functional boss when he saw them next.

The shadows were lengthening and people were tired; time to call it a day. "Well," said Joe, after he'd assigned the four tasks to different managers, "I want each of you leading a task to come back to me by the end of next week to tell me how you are going to tackle it. Now, let's have a drink before we head to the airport."

Joe realized that he had defined his own role.
His job as leader was to manage the team's boundaries.

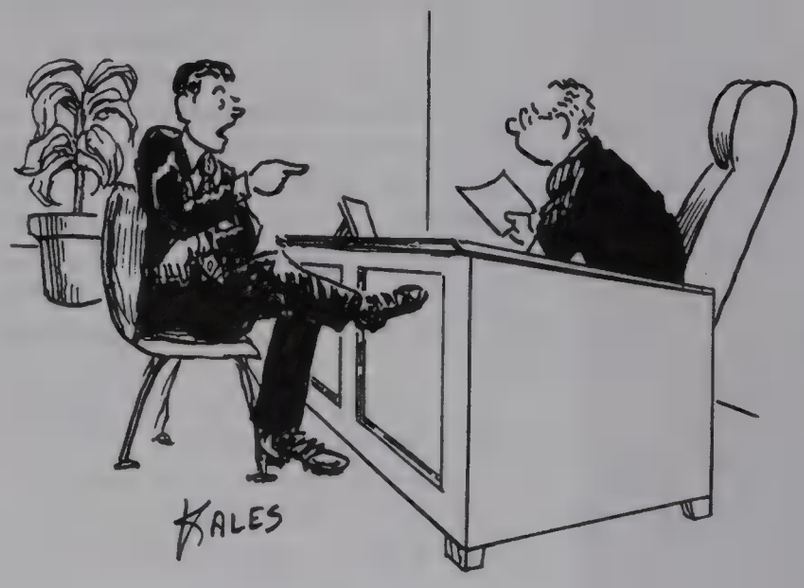
The Rollout

A single strategy briefing like the one I've just described can help an individual team perform better, but the real magic happens when briefings are held throughout an organization. When, at the end of the story, Joe assigns the tasks and asks his reports to develop their own plans, it means that they must now conduct their own briefings with their subordinates.

In each of his subordinates' statements of intent the "why" will be Joe's "what"—to accelerate delivery to market of critical products—and the "what" will be the task Joe assigned that person. So for the first of his direct reports, the intent will be "to identify the critical set of products in order to accelerate their delivery to market"; for the second, "to speed up development in order to accelerate the delivery of critical products to market"; and so on. Each of those four people's direct reports will then work out their implied tasks and pass those along to their subordinates with their "whats." The process will continue until no further analysis is necessary. In this way a company's strategy is broken down into a cascade of discrete but linked elements that give a clear view downward toward actions and upward toward the company's strategy, and align functions across the organization.

The rollout must also incorporate a feedback process in which the leader of a group that has just conducted a briefing presents the output to the people he or she reports to. In Joe's case, this "back-briefing" should involve a discussion of the metrics that he and his group came up with, which differed from the official targets.

In back-briefings three things happen. First, the unit doing the back-briefing checks its understanding of the direction it has received or worked out. Second, superiors gain clarity about the implications of the direction they originally gave and may revise it as a result—as Joe's bosses would probably do for the metrics. Third, it provides an opportunity to ensure alignment across the organization as well as up and down; if Joe's reports give their back-briefings to him together, he can check for gaps, overlaps, and coherence.



"Sir, are you sure it's a good idea to have a mission statement with irony?"

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When You've Made Enough to Make a Difference

A strategy for becoming an effective philanthropist

by William Foster and Susan Wolf Ditkoff



The fortunes that fuel philanthropy come from the likes of Bill Gates, Warren Buffett, and others on a long list of wealthy CEOs, investors, and entrepreneurs. In their respective fields, they have taken risks and enjoyed odds-beating success. They expect nothing less from their giving.

But simply writing checks to organizations that do great work won't create the ambitious changes many philanthropists are looking for. Even the richest individuals and largest foundations don't have enough money to end poverty, reverse climate change, or cure cancer. Their staggering assets are tiny relative to the dollars involved in large, complex systems like education, the environment, and medical research. According to our analysis, donations from institutional foundations and the ultrawealthy account for only 6% of the U.S. nonprofit sector's funding.

To achieve breakthrough changes, donors need a multiplier effect—an approach that delivers many dollars' worth of impact for each dollar invested. In short, they need to develop an investment model. To do so, donors must understand two fundamental areas: the methods of change that breakthrough results require (such as scaling high-impact nonprofit organizations or changing government policy) and how they can best support those efforts—through the roles they play, the resources they devote, and the relationships they develop. Just as for-profit investors need to be clear about how they can help a

venture turn a promising idea into a thriving business, investors in social issues must be clear about how they can contribute to large-scale change.

Sadly, the "money-plus" ideal is often elusive. Our work with nonprofit leaders reveals a raft of valid complaints about their philanthropic donors—who, for example, impose (usually unwittingly) significant costs of capital on their grantees. Some of these result from burdensome application and reporting requirements—waste that is widely acknowledged but persists nonetheless. Other costs are hidden, such as those resulting from the inability of donors to help with tough organizational challenges, their excessive involvement in program design, and pressure from them to develop off-mission programs. Philanthropists rarely hear this feedback directly (for obvious reasons), but it is an open secret.

Why the dysfunction? Donors often fall in love with a program model (say, charter schools) that they believe will deliver the results they want to see in the world (ensuring that all kids graduate from high school ready for college). They don't pay nearly enough attention to defining their investment model. As a result, they often add little value to their grantees, which imposes a high cost of capital. It's a scenario as hopeless as a venture capital firm's spending its time cocreating a compound with a biotech investee but being unable to help it navigate FDA approval, hire a sales force, raise the next round of funding, or negotiate with a pharmaceutical partner.

Effective philanthropists merge their program-model perspectives and their understanding of the avenues of change—a focus that informs the grantees they select and the resources they provide. For example, the foundation of conservative businessman John M. Olin supported a variety of causes in its early days, from conservation to museums. But in the wake of the political events of the 1960s, Olin became concerned about the future of free enterprise in the United States. Too few people, he thought, understood the principles of limited government and individual freedoms. Olin believed that powerful, well-researched ideas—especially those in law and economics—could have a profound long-term effect on social policies. Instead of giving to the general funds of universities, which he viewed as hostile to conservative ideals, he narrowed his focus and began supporting fledgling legal associations and law schools (the Federalist Society, for instance, and the law and economics movement at the University of Chicago). He funded conservative think tanks engaged in scholarly and legal advocacy (the Heritage Foundation, the American Enterprise Institute, and the Manhattan Institute). And he supported an array of conservative scholars who were on the cusp of true stardom, among them Allan Bloom, Bill Bennett, and Milton Friedman.

The Olin Foundation—which disbanded in 2005—could have supported many other conservative causes, and it easily could have micromanaged grantees' agendas. It did not. With an endowment that never exceeded $118 million and a handful of staffers, it is widely recognized as having done more than any other entity in the last decades of the twentieth century to establish and institutionalize the conservative movement in the United States.

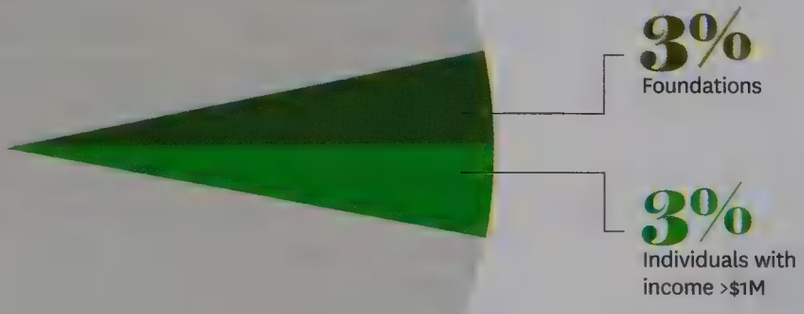
Like Olin, philanthropists can achieve a money-plus effect by first choosing the methods of change that best suit their objectives and then aligning their activities with their approach. In addition to exploring those two components of a sound investment model, we will share examples of donors that have built strong models to guide their donations and multiply their impact.

Determine the Methods of Change

There are many ways to create large-scale change. What's important is to match the method to the goal. A donor interested in increasing the use of designated

What Philanthropists Contribute to Nonprofits

Contributions from individuals and foundations make up only 6% of the U.S. nonprofit sector's revenues—not enough to achieve the large-scale changes that donors are hoping for. Philanthropists need to find ways to multiply the impact of the money they contribute.



Idea in Brief

Entrepreneurs, business leaders, and celebrities have become extraordinarily ambitious in their efforts to help solve the world's toughest problems. But writing checks doesn't accomplish much. Philanthropists need an investment model to guide their donations and multiply the impact of every dollar.

To develop a strong investment model, philanthropists must first decide what method of change best suits their goal: building a great nonprofit, influencing public opinion and government policy, or funding research. They then must decide what role to play: giving their own money, persuading others to donate, or raising awareness.

Successful philanthropists learn that making a difference requires self-discipline, planning, a focus on results, and the willingness to learn from experience.

drivers in the United States needs a different game plan than one interested in increasing the number of sustainable fisheries worldwide. The former calls for changing public norms of acceptable behavior and supporting legislation about drunk driving. The latter requires influencing a complex configuration of global supply chains. In determining which approach best suits their goals, philanthropists should consider four broad categories:

Build great nonprofit organizations. Many problems require nonprofits that can deliver services efficiently and effectively to a meaningful number of needy individuals—particularly in cases where government can't fit the bill on its own (international development, for instance, or foster care). Savvy donors recognize when and how a nonprofit needs to grow and can assist in that process. A handful have focused on helping direct-service nonprofits build their capacity and capabilities—among them, the Silicon Valley–based Draper Richards Foundation.

Built by successful venture capitalists Bill Draper and Robin Richards Donohoe, Draper Richards is a lean funder (for many years, it employed just two staffers) that follows an early-stage venture-capital model: It identifies and supports promising social entrepreneurs across a variety of fields, including education and global development. In a sharp break from philanthropic norms, Draper Richards does not have internally developed perspectives on the best programs for solving particular problems. Instead, it focuses on identifying nonprofit leaders with the greatest potential to create large-scale change. The nonprofits it funds must demonstrate four things: a great leader, a game-changing idea, programs that have been effective in the field, and sustainable operations.

The foundation also looks for nonprofits that have achieved (or can be helped to achieve) excellence in a core set of organizational activities: developing outstanding senior leadership and management practices, building a strong board, identifying and cultivating emerging talent within the organization, managing time and allocating resources effectively, building early-stage measurement systems, and finding follow-on funding. Although grantees report that excellent industry conferences are available on particular topics (such as agriculture or literacy), they are eager for coaching on the challenges of growth.

Draper Richards asks grantees to develop milestones and makes future funding contingent on meeting them. (On a few occasions, an organization's lack of progress has resulted in the termination of funding.) Over the course of a three-year relationship, a grantee's annual budget grows, on average, from $160,000 to $1.3 million. By the time

Savvy donors recognize when and how a nonprofit needs to grow and can assist in that process.



ventures graduate from the Draper Richards portfolio, they usually have a strong management team and measurement system and an ability to operate in multiple locations. They've moved from a promising idea to a promising organization, ready for the next round of funding.

Change public will and government. Some problems are best addressed by shaping public beliefs and norms—public education campaigns that expose the risks of smoking or promote the use of designated drivers, for example. Other problems call for improved government policies—such as those that create affordable housing. Nonprofits tackling challenges like these need philanthropic donors with deep expertise in government, policy making, and social media.

Consider the Open Society Foundations (OSF), established by financier and longtime philanthropist George Soros. Soros quickly recognized that the recent economic crisis would be especially devastating to America's most vulnerable people. In response, he created the Special Fund for Poverty Alleviation to provide economic relief to people in need of basic services like food and shelter while supporting policy decisions that could assist them. When a $5 billion federal stimulus package required individual states to put up matching dollars to receive federal monies, the Special Fund contributed $35 million in behalf of New York State. OSF's small staff and advisers then used their expertise and relationships to navigate a complex set of government agencies and unlock federal dollars. As a result, Soros's gift leveraged an additional $140 million for the state from the Temporary Assistance for Needy Families emergency contingency fund—a four-to-one match. This encouraged government to continue programs for those who most urgently needed assistance.



Establish intermediary organizations. Many issues, such as environmentally sustainable agriculture and green energy, involve diverse actors: consumers, government, retailers, and suppliers. Change in such areas may therefore require influencing the actions of multiple organizations, over a long period of time, in a continually shifting environment. An individual donor or foundation officer is unlikely to have the time or range of skills for this and so should consider supporting or establishing an intermediary organization. The James Irvine Foundation's approach to post-high-school education provides an example.

In California, about one-third of students drop out of high school; another third graduate unprepared for work or college. After much research and evaluation, the foundation—established during the Great Depression by California agriculture expert and businessman James Irvine—identified as a possible solution the Linked Learning approach (formerly known as "multiple pathways"), which aims to develop curricula around industry themes (such as engineering and biomedicine), thereby providing students with technical skills and real-world experience in personally meaningful areas. However, the foundation understood that spreading Linked Learning—gaining support from parents and students across the state—would be a long-term and complex task.

So in 2006 the foundation created ConnectEd: The California Center for College and Career. With a staff of 20 and offices in San Francisco and Los Angeles, ConnectEd leads demonstration projects, offering coaching and funding to 10 California school districts; promotes collaboration through tools and

Michael J. Fox has brought much more than money to his efforts to cure Parkinson's disease.

training that it distributes and implements in the school districts; advises policy makers; and builds awareness through publications, websites, videos, and conferences. Over time, ConnectEd has built a coalition of more than 60 organizations (from education, labor, and industry) to promote this approach to improving educational outcomes.

Research and develop solutions. Sometimes the problem is the lack of a breakthrough solution: Think of a new drug that cures a disease or a new technology that collects solar energy with greater efficiency. In this case, the key to philanthropic success is helping to break down barriers and rivalries and keeping a clear focus on the quickest and most efficient route from research to breakthrough.

The Michael J. Fox Foundation (MJFF) is a nonprofit dedicated to finding a cure for Parkinson's disease. The foundation invests nearly $50 million per year toward this cause, but it knows that is not enough to develop a cure. So MJFF's investment model focuses on influencing the entire research community to improve its performance, which not only brings scientists closer to a cure but also lowers the investment risk for other groups interested in Parkinson's drug development. MJFF wants to break the culture of academic secrecy, which it believes limits the pace of scientific advances. To do this, it has assembled a blue-chip scientific advisory panel; a team of in-house scientists with the technical savvy to vet ideas and ask tough investment questions; a council that represents the voice of the beneficiaries in the priority-setting process; and an executive team with deep strategic-planning expertise. Guided by the executive team, these groups have developed a high-level map of potential pathways to a cure and a detailed assessment of their likelihood of success. As a result, MJFF's research grants are carefully targeted, with each new one informed by the work being conducted across the entire field. With no corporate profits or academic prestige at stake, MJFF is well placed to assemble a fascinating array of players. The National Institutes of Health, pharmaceutical companies, venture capitalists, and other entities recognize the unique value the foundation adds and increasingly consult it as they consider investments.

Align Activities

Once philanthropists are clear about the methods that best suit their goals, they must organize their activities accordingly. That means coordinating the *role* they'll play, the *human resources* they'll call upon, and the *relationships* that will support their efforts. We present these three factors sequentially here, but in practice they're interrelated.

Defining the right role. The best role matches the donor's capabilities with what's needed to achieve results. The most obvious role involves the awarding of funds: Should they be spread across many grantees or concentrated on a few? Should they be put toward establishing a new organization or strengthening an existing one? Should they be traditional grants or leveraged balance sheets? The answers to those questions can't be driven by personal preferences alone; they must be informed by what it will take to create change.

Other roles can be nonfinancial, drawing on philanthropists' personal skills and networks. Michael J. Fox, for instance, has brought much more than money to his cause. He has leveraged his public persona and credibility through high-profile television appearances (he was on *The Daily Show* in 2009) and in various forms of social media. Other major donors to MJFF also play crucial nonfinancial roles. Andy Grove, the former chief of Intel, brings his engineering background to discussions about how potential therapeutics can cross the blood–brain barrier, a particularly thorny problem.

A cautionary note: Philanthropists playing nonfinancial roles should stick to areas where they bring unique skills or relationships and not try to claim expertise they do not have. Positive interventions can include providing connections to a nonprofit or initiative, convening key stakeholders and experts, attracting support from government and corporate leaders, and providing strategic or tactical support (such as offering advice about organizational design or providing training to the sales force).

To determine the most appropriate financial and nonfinancial interventions, philanthropists should consider their abilities relative to those of other investors, intermediaries, the government, and grantees. And, of course, they must listen carefully to beneficiaries and attend to their needs.

Assembling the right human resources. Often a donor is not well positioned to play the role he or she wants to play and thus must build, buy, or borrow the capacity to do so. Some philanthropists build talent within their grantee organizations; others hire staffs to carry out their grant-making operations. Still others rely on contractors or other borrowed talent.

A cautionary note: Philanthropists should stick to areas where they bring unique skills. They should not claim expertise they don't have.

MJFF chose the *build* route, using celebrity, strategic planning, and scientific expertise to bring together a broad group of stakeholders in a new way. Irvine chose to *buy* expertise by investing in an intermediary rather than foundation staff. To develop its Special Fund, OSF had a similar need for experienced talent but had to act quickly and didn't have the time to hire a large staff. So it *borrowed* expertise by creating a unique executive-on-loan partnership with two leading antipoverty funders, the Annie E. Casey and Charles Stewart Mott Foundations. With just one full-time staffer, OSF relied on loaned executives, volunteer expert advisers, and experienced short-term consultants to inform its work and invest nimbly and expertly across a range of opportunities.

Forging the right relationships. Healthy, productive relationships between donors and grantees are essential to money-plus philanthropy. But the inherent power dynamics create challenges. As we mentioned earlier, donors rarely get honest feedback from grantees about what adds value and what just creates costs. A strong investment model can increase the odds of success for donors—by engendering honest conversations when they push for off-mission programs and promoting shared expectations about their contributions and grantees' needs. It's important to ensure that the requirements grantees must fulfill do not eclipse the value of the benefits they'll receive. For instance, OSF keeps grantees' paperwork low relative to the multimillion-dollar awards it makes; and Irvine helped ConnectEd build the 60-organization coalition because it realized that Linked Learning's overall success depended on help from others. In contrast, Draper Richards requires a lot of time and effort from grantees, but the staff provides commensurate value.

The reality is that the power dynamics can be mitigated but not eliminated. Donors must be hypervigilant about respecting grantees. This does not mean that philanthropists should get rid of all burdens. After all, many good philanthropic practices—such as thoughtful performance assessment—create costs. The higher the benefit, the more justified any burdens become. But when donors don't understand what their grantees need and the costs of capital they're imposing, the stage is set for trouble.



"Rock—you I can cover. Scissors—you're too big a risk."

SOCIETY IS blessed with ambitious philanthropists and promising ideas. To address the world's most pressing problems, donors must ask themselves if they truly understand what it takes to make change happen, beyond just a great program or idea, and if so, how they can position themselves—through their role, resources, and relationships—to support that change. Without a fully integrated picture, philanthropists can't effectively communicate and coordinate with other donors, collaborate with grantees and beneficiaries, and improve their decisions. They become vulnerable to wishful thinking and unrealistic expectations. Developing a clear investment model does not have to be complicated or expensive, just deliberate—and the model evolves as philanthropists learn from their experiences. No external force will make donors do this—only self-discipline and a relentless drive for results.

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Investing in the Post-Recession World

Where companies should go for growth amid uncertainty

by Sage Newman, Courtney Rickert, and Ross D. Schaap

Opportunities for corporate growth in 2011 seem to be both everywhere and nowhere. The global recession is officially over, but it's still haunting much of the world. Government actions and contradictory economic trends further confuse the picture: Brazil is planning to spend while Australia is cutting back. Trade tensions are rising between the United States and China. Indonesia tempts inflation by keeping rates low.

Emerging market economies such as India are growing vigorously, offering hope for multinationals intent on expansion. Yet in virtually every country, negatives vie with positives, partly because of variation in how countries have managed the downturn. Are they stimulating their economies? Courting foreign direct investment? Imposing austerity?

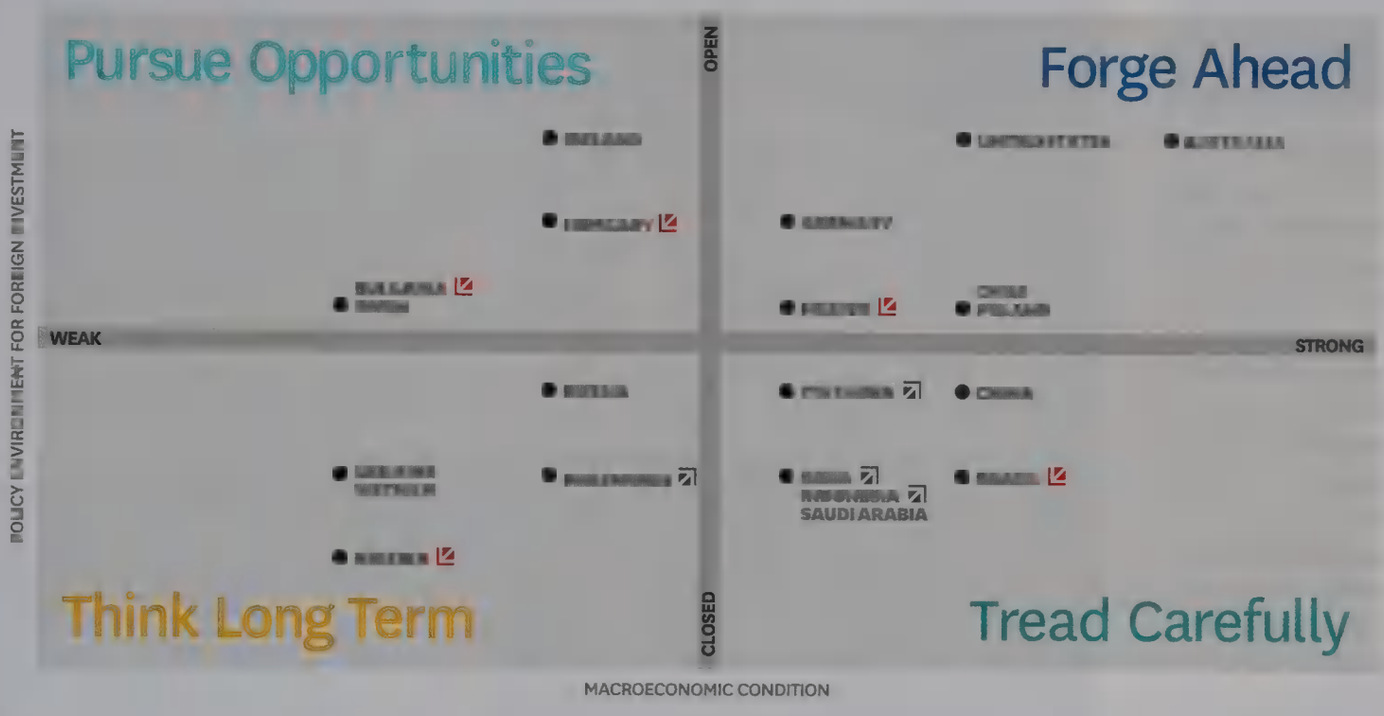
Companies need a way to cut through the chaos and avoid pitfalls. Here we present a guide—based on an aggregation of political and macroeconomic factors—for determining where growth is likely, which governments are encouraging or impeding foreign investment, and which sectors in those countries provide the greatest opportunities.

Drawing on Eurasia Group's political analyses and on economic databases from sources such as the International Monetary Fund, we assigned scores to countries on the state of the macroeconomy (which affects issues such as consumer demand, labor unrest, and exchange rate stability) and on foreign investment policy (which affects multinationals' access to opportunities). We plotted the countries on a graph and divided them into four groups, ranging from least to most risky. Although other factors also matter to multinationals, we focused on those two issues because they are affected by political decisions, which can be difficult to comprehend and can change unexpectedly.

Some of the results are surprising. Chile, with its stability and transparency,

A Global Map of Opportunity and Risk

Multinationals are emerging from the recession and beginning to look for opportunities to invest in global markets. But before targeting a specific country, managers need to understand the state of its macroeconomy and its friendliness toward foreign investment. This chart shows at a glance how various markets—emerging and developed—stack up. The arrows signal improvement or deterioration in countries' foreign-investment policy environments.



comes out ahead of perennial investment favorite Brazil. China has a more-favorable investment environment than India, but that gap is likely to close as India's government implements a variety of policy changes.

How We Assigned Scores

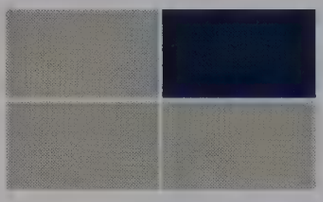
To assess a country's macroeconomic condition, we drew on data that correlate with economic conditions, including GDP growth, inflation, exchange rate volatility, government budget balance, current account balance, and foreign exchange reserves. To evaluate a country's policy environment, we used political data and analysis from Eurasia Group. We measured how hospitable the policy and regulatory environment is for foreign investment by assessing the extent to which government policies (such as regulation) and practices (such as corruption) inhibit economic activity. For both macroeconomic conditions and policy environment, we used scales of 1 to 10, with 1 representing the greatest degree of risk and 10 the lowest.

As an example, an analysis of Spain's macroeconomic conditions reveals deterioration in several variables in the past year. For instance, the unemployment rate increased from 18% in 2009 to an estimated 19.9% in 2010. The exchange rate volatility of the euro also increased over this period, which decreases the stability of the macroeconomic environment. In addition, Spain's real GDP growth is slow in comparison with that of other countries: The IMF estimates that Spain's economy contracted 0.3% in 2010 and will grow only 0.7% in 2011. The government's policies have not helped Spain's macroeconomic condition: In January 2010 the government introduced austerity measures that included a decrease in public sector wages, increases in the value-added tax, and income taxes on high-income earners. Although the government is implementing austerity to appease bond investors, these policies limit consumer demand, while spending cuts keep public expenditures from rising to offset the decrease in demand. Thus Spain's macroeconomic score decreased over the past year. A variety of market indicators corroborate the deterioration in Spain's macroeconomic environment, including a 5.3% decline in the country's equity markets and a 16% increase in the government bond yield year-on-year to October 2010.

In the following pages, we will take you through a selection of emerging and developed markets where there is a potential for policy change or where our findings may contradict conventional wisdom.

Turn the page for a country-by-country analysis of risks and opportunities.

Forge Ahead



Multinationals investing in these countries can feel confident: Governments are promoting foreign investment, and the relatively strong economies mean that domestic demand will probably be substantial and labor unrest will be limited.

In the Asia-Pacific region, Australia's economy will continue expanding. In Europe, both Germany and Poland are expected to have positive macroeconomic and policy environments, but growth in Germany is expected to slow in 2011.

These countries are the most obvious choices for foreign investors, so competition for opportunities will be intense.

	Macroeconomics	Foreign investment	Sectors
Australia	Despite the expiration of stimulus measures, Australia's economy is projected to grow by 3.5% in 2011, aided by booming commodity exports. Investment and consumer spending are slowly rebounding, but currency appreciation is a concern for exporters.	Foreign investment will continue to play an important role. Contrary to popular perception, Canberra has not rejected any of China's 200 investment bids in the past three years. Australia is also exploring trade agreements with most Asian economies.	Although the investment environment is generally positive, an unclear carbon policy outlook clouds the prospects for the electricity and industrial sectors. And a proposed tax on coal- and iron-ore-mining companies could limit new mining investments.
Chile	Chile's economy continues to recover swiftly from the global financial crisis and the February 2010 earthquake. Growth is expected to be 6% in 2011. Inflation is predicted to remain low, at 3%, which gives the central bank room to raise rates gradually without threatening the recovery.	Chile remains one of the most open economies and may have the most predictable policy environment in Latin America, a situation that is unlikely to change anytime soon. The stability and transparency of Chilean institutions attract foreign investors.	The government raised taxes on most large corporations in 2010 to finance $8.4 billion in postearthquake reconstruction, which is likely to provide opportunities for infrastructure investment. Chile's currency appreciation hurts the competitiveness of exporters, especially in agriculture.
Germany	During the recession, Germany had the resources to stimulate its economy, and so its recovery has been stronger than those of other EU members. Growth is projected at 2%, but the country's eurozone trade partners are implementing austerity, which will constrain demand for German exports.	Reliable contract and competition enforcement makes Germany a stable investment destination. The tax regime is complex, but the government may simplify the corporate tax code in 2011. Labor costs are competitive, despite somewhat rigid labor-market regulations.	The government plans to increase spending on education and research to 7% of GDP by 2015, in part through grants to domestic and foreign businesses. In addition, the government is financing research and development in energy technologies, such as offshore wind farms.
Mexico	The Bank of Mexico estimates 2011 GDP growth of 3.2% to 4.2%. There are signs that internal demand is recovering, but inflation is high, at an estimated 4.4% for 2010.	Owing to the government's push for antimonopoly measures, Mexico will continue to attract multinationals. But organized crime makes it a riskier place for investment than other countries in the Americas. There were 12,000 drug-related deaths in 2010.	The government recently promoted telecommunications investment by allowing cable companies to provide phone services. In the energy sector, a 2008 law gives companies cash bonuses for technological transfers and timely contract fulfillment.
Poland	Poland's economy, forecast to grow by 3.7% in 2011, remains one of the strongest in the EU. Inflation remains in check, at 2.7% in 2010. The government will seek to avoid measures that would dampen consumer demand.	Foreign firms have strong positions in a range of sectors because of Poland's competitive corporate tax rates and substantial domestic demand. The government would like to implement additional market-friendly reforms but will wait until after the 2011 elections.	In preparation for hosting the 2012 European soccer championship, Poland has accelerated investments in stadiums, roads, hotels, and rail lines. State-controlled commodity firms are likely to look for foreign partners to help their technological development.
United States	It is expected that growth will be below 3% until 2012 and that inflation will remain too low to be healthy. Consumers are likely to stay cautious as they cope with high unemployment and a decline in household wealth.	Although trade tensions with China will continue through 2011 and policy makers are reworking the corporate tax system, there is little risk that the United States will turn sour on foreign investment.	President Obama's upcoming budget will seek to make permanent an R&D tax credit, which is most beneficial for high-tech industries. However, such tax credits are likely to be incremental rather than permanent, as policy makers focus on deficit reduction.

Tread Carefully

	Macroeconomics	Foreign investment	Sectors
Brazil	Brazil's economy is forecast to grow by 4.1% in 2011, with moderate inflation of approximately 4.6%. Growth will be driven by domestic consumption as credit markets expand for the country's ascendant middle class.	The government recently passed a measure allowing domestic companies to be favored in government contracting. And if the Brazilian real continues to appreciate, the government will face pressure to intervene again in currency markets—possibly by imposing additional capital controls.	The government has vowed to increase public investment in transportation and energy infrastructure—a commitment that will only increase as the country prepares to host the 2014 World Cup and the 2016 Olympics. Those areas are attractive opportunities for foreign investment.
China	Consumer demand benefited from China's stimulus spending. The country's economic growth, forecast at 9.6% in 2011, will let policy makers guide the overheated property market to a soft landing. Rising domestic consumption and exports will drive expansion.	Foreign investment continues to be a priority, but the government fails to protect intellectual property rights and limits market access for foreign firms in order to boost domestic ones.	The government unveiled a plan to make China the world leader in the electric vehicle market, earmarking $14.7 billion in investment over 10 years. The proposal has drawn criticism for favoring state companies while marginalizing foreigners and China's private sector leaders.
Colombia	Colombia's economy is expected to grow by 4.6% in 2011. Inflation has remained comfortably within the central bank's target and is expected to hold steady at around 2.6% throughout 2011. Consumer demand, especially in the retail sector, has been strong.	The center-right government of President Juan Manuel Santos is likely to continue pursuing market-friendly economic policies aimed at attracting and retaining FDI, especially in the burgeoning oil and gas sector.	Colombia is rising in the ranks of Latin America's oil and mineral producers, thanks to a recent surge in FDI. The country's improved security situation and favorable investment terms will continue to drive interest in oil, gas, and mineral exploration.
India	India's economy is expected to continue growing robustly in 2011, at 8.4%, according to the IMF. Meanwhile, the central bank has begun raising interest rates to slow core inflation, a measure that will dampen consumption and investment.	Given India's limits on foreign equity ownership, capital controls, and extensive licensing requirements, the investment environment can be difficult for foreign companies. However, the government may reduce corporate tax rates for foreign investors.	The government is poised to ease FDI restrictions in the retail and insurance sectors. India's use of public–private partnerships to expand and improve the national highway system creates opportunities for foreign investment in infrastructure.
Indonesia	Indonesia's surprisingly strong growth in 2010 is expected to continue in 2011, with expansion forecast at 6.2%. Growth will give the government more resources to invest in infrastructure, but domestic consumption, which has been the economy's main engine, could be hurt by resurgent inflation.	Private investment is a critical element of the government's growth strategy. President Susilo Bambang Yudhoyono has embarked on an ambitious three-year effort, including restructuring and privatization, to reform Indonesia's inefficient state-owned enterprises.	The government is promoting investment in utilities, especially electricity. Another growth area is green industries, particularly geothermal energy. The government is planning $20 billion of investment in this sector by 2025 and has improved regulations to attract other investors.
Saudi Arabia	Saudi Arabia's macroeconomic outlook is generally positive, with growth forecast at around 4.5% for 2011. Inflation, projected at 5.3%, is likely to continue exerting pressure but will probably not have a significant impact on consumer demand.	Although Saudi Arabia's business environment ranked 13th in the world in 2010, it placed 140th on contract enforcement. Progress on judicial reform is critical. King Abdullah has pushed to clarify and codify the Saudi legal system, but his eventual successor could disrupt reforms.	Saudi Arabia recently implemented a five-year, $385 billion development plan in a bid to diversify its economy and place Saudis in skilled positions currently held by foreigners. The plan offers opportunities in engineering, architecture, and other industries involved in infrastructure and construction.

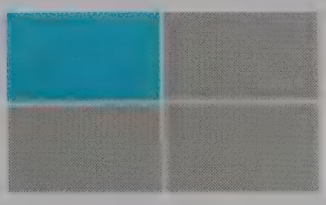


Macroeconomic conditions in these countries are good, but the political environments are less favorable for foreign companies.

In South America, Colombia is more eager for foreign investment than Brazil, which is enacting policies to favor domestic firms. In Asia, both India's and Indonesia's investment environments are improving.

To penetrate these markets, multinationals may want to establish partnerships with local firms.

Pursue Opportunities



Macroeconomic conditions are weak in these countries, but governments are implementing policies that are favorable for foreign investors; external investment could eventually improve domestic demand.

Compare Bulgaria and Spain: They have similar policy scores, but Bulgaria gets demerits for corruption and opaque policy making, whereas Spain's score is partly a result of its slow response to fiscal problems.

With friendly policies and relatively inexpensive labor and other inputs, these countries may represent attractive sourcing locations.

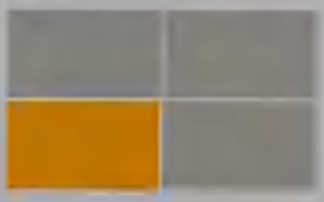
	Macroeconomics	Foreign investment	Sectors
Bulgaria	Bulgaria is recovering slowly from the global financial crisis. The economy is expected to grow by 2% in 2011, and domestic demand will likely remain subdued. Inflation is forecast at 2.9%.	Low tax rates (10%) and labor costs have attracted many investors from Western Europe, notably Italy. However, corruption remains a significant impediment to doing business. In addition, a lack of transparency surrounding the government's budget and the country's halting efforts on health care reform will continue to cloud the policy environment.	The government has recently shown interest in green initiatives, raising funds from European investors to develop renewable-energy projects and announcing the creation of a green building code that will require international expertise. Experts have identified Bulgaria's potential for wind power, and the government hopes to promote opportunities for foreign investment in that area.
Hungary	The IMF projects that Hungary's economy will grow by just 2% in 2011, which is below expected regional growth of 3.1%. Household spending will be constrained by austerity measures and onerous mortgage payments on foreign-currency-denominated loans.	The economy is generally open to foreign investment, but the current government's hostility toward FDI in certain sectors has dampened the policy environment. Politicians have criticized previous governments for giving away too much to foreigners and have adopted a populist, antimarket tone.	The most notable bright spot has been the auto industry; Audi and Opel recently announced new investments. Banking, by contrast, provides fewer opportunities: The government imposed a temporary 0.6% tax on bank assets through 2012. Telecom, energy, and retail were also recently targeted for a 50% tax rate on profits through 2012.
Ireland	Ireland faces mounting challenges in 2011, including costly bank bailouts, a strict austerity budget, and a probable election in early 2011. Although GDP growth is projected at 2.3%, inflation is forecast at negative 0.5% in 2011, indicating weak consumer demand.	Ireland's low corporate tax rate of 12.5%, intended to woo foreign investors, has come under EU pressure. The government is unlikely to increase the rate in 2011, but the high budget deficit may force officials to reconsider.	The government's recently unveiled strategy for promoting investment and trade is intended to generate 150,000 jobs in manufacturing, tourism, and trade-related services through 2015. Officials will encourage foreign investment by removing anticompetition regulation in the professional services, transport, and energy sectors. Existing incentives include a 25% tax credit for R&D.
Spain	The IMF projects real GDP growth of just 0.7% in 2011, and the government is cutting social spending. Elevated unemployment and household debt, as well as reduced government expenditures and tax hikes, undermine consumer demand and the outlook for economic growth.	The government perceives foreign investment as important for economic growth but will likely remain averse to foreign takeovers of strategic sectors such as utilities. Despite labor reform in 2010, high labor costs and complex wage agreements are likely to continue limiting efficiency.	The government prioritizes private sector R&D and continues, despite recent austerity measures, to fund programs that promote research. Spain provides financing, technical support, and identification of partners for domestic and foreign firms in innovative sectors—particularly health, automotive, renewable energy, and information and communications technology.

Think Long Term



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	Macroeconomics	Foreign investment	Sectors
Nigeria	The economy is expected to grow by 7.4% in 2011, buoyed in part by a moderate uptick in oil production. Fiscal policy, however, will be challenged by growing pressure from state governments to draw down funds in an oil windfall account, as well as by election-related spending.	Nigeria has pursued liberal economic policies to attract investment, but obstacles such as multiple taxation, power shortages, and overlapping levels of bureaucracy impede foreign investment. Strict local-content rules in the hydrocarbons sector are likely to tighten.	It is unclear whether Nigeria's new oil-sector legislation will be sufficient to reinvigorate industry enthusiasm for the deepwater oil sector. The power sector may provide more opportunities—a proposed reform would privatize generation and construct a new transmission network.
The Philippines	Private sector investment, exports, and consumption will drive economic growth, projected to be 4.5% in 2011. Unlike other Southeast Asian countries, the Philippines depends on exported services (such as business process outsourcing and temporary workers abroad), which have been resilient.	The government's reforms will focus primarily on reducing the red tape constraining foreign investment. However, the current administration's strong ties to domestic businesses argue against significant liberalization in many of the country's major sectors.	Infrastructure—particularly toll roads and power—and mining could be among the major growth sectors as related policies stabilize. Much of the improvement will be due to increased domestic investment in those sectors by influential local players, which will lead to demands for better and more-predictable regulation.
Russia	Russia's economy is continuing to recover; the IMF forecasts GDP growth of 4.3% in 2011. Inflation was projected to hit 8% to 9% in 2010 and is expected to remain high in 2011. But domestic consumption is strong, supported by solid growth in disposable income.	Improving the investment environment—in particular, focusing on corporate governance, stemming corruption, and upholding the rule of law—is a top priority for President Dmitry Medvedev. Rhetoric notwithstanding, it is unlikely that there will be significant material improvement in the medium term.	The government has announced a broad but vaguely defined program to diversify the economy by, for example, increasing investment in knowledge-based industries. The government's focus is on the renewable energy, IT, communications, biomedical, and nuclear sectors.
Ukraine	Ukraine's economy is expected to continue recovering from the worldwide downturn. The 4.5% growth in 2011 forecast by the IMF depends on external demand for steel and other exports. Higher natural gas and food prices are boosting inflation, potentially decreasing consumer demand.	The government has taken few steps to advance its goal of improving the investment environment, leading to concerns about the government's commitment to such policies. A reformed tax code (including reduced corporate-profit taxes), going into effect in early 2011, may help, but businesses are not happy with some changes.	The government has sought outside investment for infrastructure projects for the Euro-2012 soccer tournament, as well as for boosting energy efficiency. Direct budgetary and regulatory support has been minimal, however. Improved Ukrainian–Russian relations will lead to further Russian investment, possibly in telecommunications, aerospace, and chemicals.
Vietnam	The IMF estimates that Vietnam's 2011 growth will be 6.8%, but the economy's expansion will depend on the global recovery. Much of the growth will come from greater trade and private investment. The government's challenge is to create a favorable environment without stoking inflation.	The government will continue its efforts to improve the climate for foreign investment. But progress will be uneven, in part because of the maneuvering between reformists and conservatives, who believe that slower reform will prevent shocks for domestic sectors and local interests.	Reform of state-owned enterprises and a public investment program will be among the most critical changes in 2011. The near bankruptcy of the country's largest shipbuilder and frequent power outages have strengthened the push for reforms. Export industries will also continue to receive positive treatment from the government.



Investing in these countries, where macroeconomic conditions are poor and government policies largely discourage foreign investors, involves taking on more risk.

Russia and Ukraine face some of the same uncertainties: Economic growth in both depends in part on external demand for their commodities—hydrocarbons and steel, respectively. But neither government is likely to substantially improve its foreign investment environment. The government of the Philippines is making slow progress toward improving the foreign investment environment.

There may be strategic advantages to entering these markets now in pursuit of long-term opportunities.

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THE CHALLENGE Should new products be developed in-market or adapted to market? What can companies do to ensure that innovation equates to better business?

Innovate or Adapt? The Challenge of New Markets

Whether it's the economy or the environment, one thing is certain: The future of the world is inextricably linked to the future of business. More than ever we need to find innovative solutions that can turn human business challenges into opportunities.

By bringing visionary experts in diverse fields to the table, the Singapore Sessions explore the diverse solutions that are possible for any given challenge and offer unique insights into how we might answer some of tomorrow's challenges today. To join the conversation or to explore other sessions, visit **SingaporeSessions.com.**



DR. JAGDISH SHETH

Charles H. Kellstadt Chair of Marketing, Goizueta Business School at Emory University

Jag Sheth has worked with companies around the world to understand the unique opportunities and challenges in bringing new products to emerging markets. He is the author of *Chindia Rising: How China and India Will Benefit Your Business.*

HISTORICALLY, COMPANIES HAVE RELIED on local adaptation strategy to deliver their products in a way altered to deal with differences in culture, geopolitical distance, regulation, and different levels of economic development. All of this is changing with the rise of emerging markets, especially China and India. Innovation is shifting from adaptation to in-market development in emerging markets with a focus on opportunity, affordability, and sustainability.

Converting unbranded and unorganized markets into branded organized markets is key to future innovation and business success. In many ways, this is exactly what Wal-Mart did in rural America and what Ford Motor Company did with the Model T. America has been a pioneer nation in converting non-users into users. The most recent example is the cell phone technology. None of us needed it until we started using it. Now we cannot live without it. Today, the largest markets for cell phones are China and India: China has more than 700 million cell phone users.

Large emerging markets such as China, India, Brazil, Russia, Turkey, and Indonesia will necessitate more in-market, low-cost innovation, which makes emerging products more affordable and accessible.

But companies also are moving to in-market innovation because of the low-cost innovation in emerging markets. Since the cost of innovation there is at least ten to fifty times cheaper than in advanced countries, it is much cheaper to fail. Another factor behind in-market product development is emergence of a global mindset. Increasingly, many emerging economies are demonstrating significant capability to innovate with scarce resources and poor infrastructure. Brazil has led the world in ethanol; China leads the world in solar energy. The innovation fever in emerging markets is also prevalent in such basic industries as education, health care, and defense. The scientific community in advanced economies now recognizes the capabilities of scientists of emerging markets.

Finally, in-market development helps further the fusion of different disciplines, cultures, and processes of innovation. This means fusion of biological and physical sciences, as well as fusion of electronics into everything to make it smart. It also means blending global talent to work together in virtual teams. This fusion will make the debate whether to innovate in-market or adapt to local needs moot.



INDER SIDHU

Senior Vice President, Strategy and Planning, Worldwide Operations, Cisco

Inder Sidhu is a member of the company's operating committee and has co-led Cisco's Emerging Countries Council and its Enterprise Business Council. He is also the author of *Doing Both: How Cisco Captures Today's Profits and Drives Tomorrow's Growth.*

IMAGINE A WORLD in which a child can attend school for just $1 per month and where a visit to a doctor costs less than a candy bar from a vending machine. Fantasy, right? Not to Cisco. We are working to make accessible education and affordable health care a reality for literally billions of people.

So how did Cisco[1], the world leader in techie communications gear, position itself to make such a contribution on a global stage? The answer has a lot to do with how we see the world—where we develop innovation, in particular.

For much of our 25-year history, Cisco developed products in Silicon Valley and then adapted them to local markets worldwide. The model provided a significant return on our engineering investments and made us one of the most valuable companies in the world. As Cisco expanded into new customer segments and geographies, however, the model started to show its limits. It did not always produce the best solutions for given challenges. In the consumer market, our innovations were overly complicated; in emerging markets, they were too expensive.

We've done many things to reduce the gap between our capabilities and our customers' needs, but one of the most beneficial was to adjust our product development model. While we continue to develop platform products at our headquarters in California, we now leverage the insights and ingenuity of local talent in China, India, Norway, Israel, the U.K., and elsewhere.

When it comes to adapting innovations to a market or developing them in a market, we no longer make a false trade-off. Instead, we have committed to doing both.

This decision is helping Cisco create technologies that tackle some of the world's most pressing challenges. Take our effort to combat problems caused by global urbanization. Today more people live in urban areas than in the countryside for the first time in history. In five years, the population of cities is expected to swell by an additional 500 million people. The need to sustainably manage social, economic, and environmental resources has never been greater.

To help in this effort, Cisco developed a family of video, collaboration, and communications solutions that make city life more manageable. Need to visit a doctor? In a Cisco Smart+Connected Community (S+CC) you will be able to see a doctor online at your convenience for just $1. You will also be able to send your child to school for pennies a day and renew your driver's license without leaving your home, all because of local and global data networks that virtually eliminate the barriers of time and space.

Cisco S+CC solutions also provide tools for increasing services and improving public safety. With video cameras installed all along roadways, transportation officials can monitor not just crime but also traffic congestion, and even remotely update digital signs to redirect traffic in emergencies.

Like a growing number of Cisco innovations, our S+CC solutions are a blend of adapted-to and developed-in market solutions. While the underlying architecture is being designed in Silicon Valley, the vertical applications are being developed in India, home to our Globalization Center.

Cisco chose India for this work because our 6,000 engineers there have a unique appreciation of how serious global urbanization has become. Their country is home to eleven of the world's fastest-growing cities. In Bangalore, 1,000 new cars are put on the street every year. Clearly these engineers have a passion for technology that can transform lives in a single generation.

When they are done, our Indian engineers take the best of what they produce and then apply it to the work of their Cisco colleagues around the world. What starts as an in-market idea in one place often becomes an adapted-to market innovation in another. Doing both creates a multiplier effect for our company and is the platform for taking on some of life's biggest challenges.

Great ideas can come from anywhere. If you can apply them everywhere, you can change the world.

[1] In 2008, Cisco launched the inaugural Enabling Platform Innovation Center (EPIC@SG) in Singapore with the support of the Infocomm Development Authority of Singapore (IDA). EPIC@SG is a significant milestone in Cisco's global strategy to bring innovation centers closer to where it sees new business models and new world services emerging. Equipped with state-of-the-art facilities, this technology center is designed to help retail service providers build and deliver ultra-high-speed broadband network services.

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SCOTT ANTHONY

Managing Director, Innosight Ventures

Scott Anthony leads the Asian operations of Innosight, a strategic innovation consulting and investment company with offices in Boston, Singapore, and India. He is the author of the forthcoming book *Cracking Innovation's Black Box.*

//// **IT NEVER HAS BEEN** more important to target new markets. Continued economic pressure means today's markets are unlikely to be the source of blockbuster growth. Competitive advantage in established markets is increasingly looking like a transitory notion.

And companies increasingly recognize that reaching new markets requires developing products and services that are attuned to local needs. Despite this understanding, many companies still struggle to get traction in new markets. What explains the disconnect?

At least one explanation is that companies are limiting in-market development to the features and functions of the products they sell and the services they offer. That's a great start, but companies need to go further. They have to adapt their very business models.

Never forget that "innovation" goes well beyond the features and functions of your offering. Look, for example, at the four most successful technology companies of the past decade—Apple, Google, Netflix, and Amazon.com. What made all these companies successful was a business model that disrupted their respective markets.

That's not to say that companies always need to follow different business models to win in new markets. Sometimes, in fact, leveraging your current business model is the exact way to win in a new market.

At Innosight, while we are experimenting with new models such as venture capital offerings, and outsourced incubation services, a key part of my role is to explore bringing our consulting model to Asia. The clients we serve in the United States tend to be senior leaders looking for fresh insights on topics of growth and innovation. The clients we are targeting in Asia are also senior leaders looking for strategic insights on these same topics. I'd be foolish to not find ways to leverage as much of our core model as I can.

Of course, there are some local flavors to anything you do, which is why I moved out to Singapore in early 2010. The country's position as the gateway to Asia made it a local base for our international expansion.

Looking for a shorthand way to determine whether substantial rewiring is required? Ask a simple question. Am I targeting the same type of customer in the new market as I serve in my existing market? If you sell to businesses and you hope to target consumers, if you sell to upper-income consumers and you hope to target the middle of the economic pyramid, or if you sell to specialist doctors and you need to sell to general practitioners, the odds that you need to innovate from the ground up are high.

Two final pieces of advice. First, it is easy to think you understand the new market you hope to target. But unless you have invested the time to spend a lot of time in that market, the odds that you really understand it are low. Well-orchestrated trips involving five-star hotels and scripted meetings won't suffice either. People making decisions about those markets have to really understand the fabric of the market, which means, in the words of one of my colleagues, "going native." Read Bruce Brown's piece—researchers spent thousands of hours in market to understand the wants, needs, and desires of local Indian consumers.

Second, it won't always be clear where you sit on the adapt vs. de novo development spectrum from day one. That places a big premium on structured experimentation—thoughtfully running experiments to address critical unknowns before making big investments.

Getting this question right isn't easy. But sustaining real competitive advantage means thinking differently and acting differently.



BRUCE BROWN

Chief Technology Officer, Procter & Gamble

Bruce Brown oversees the company's innovation program, its 8,700-person global R&D organization, and its nearly $2 billion annual investment in R&D. Bruce also oversees P&G's Corporate Innovation Fund and FutureWorks organization for creation of new business opportunities and capabilities.

//// **OUR PURPOSE AT** Procter & Gamble[2] is to improve the lives of the world's consumers. It is so pervasive that it inspires our growth strategy to "touch and improve more consumers' lives, in more parts of the world…more completely."

We improve more consumers' lives by innovating and expanding vertically, up and down value tiers. We improve lives in more parts of the world by innovating and expanding geographically into new white spaces where we have not been competing. We improve lives more completely by innovating to improve existing products, creating or entering adjacent categories, and driving regimen use that broadens our product portfolios.

Innovation is how we fulfill our company's purpose and meet our growth goals. It all starts with a thorough understanding of the consumer. With products reaching over four billion consumers in about 180 countries, we must be laser-focused on the consumer's articulation of needs and definition of value.

To support this focus—and to decide whether to develop new products for a market or adapt existing products—we consider three principles: 1) Define the target consumer; 2) Design for this consumer; and 3) Execute for this consumer. This approach is well illustrated with our October launch of the Gillette Guard shaving system in India. As the first Gillette product designed specifically for men in markets like India, Gillette Guard is one of the most significant product launches in Gillette's history.

When defining the target consumer, we learned that nearly one billion men were shaving using technology invented by King C. Gillette more than 100 years ago—double-edge razors—because there was no better, affordable alternative. So we looked at every element of our innovation process, from consumer understanding to design to manufacturing, to create a product for these men while managing costs to meet their affordability criteria in a sustainable business model.

We designed for this target consumer by spending thousands of hours with men in India to better understand their shaving needs. They participated in interviews, in-home visits, "shop-a-longs," and test shaves to shape and fine-tune the razor's performance. We learned they value safety, ease of use, and affordability above all else. We discovered they need a razor to help manage longer hair because they don't shave every day. They place high importance on easy-rinsing technology, as many do not have running water in their homes. We also saw unique gripping patterns by Indian men when shaving that needed to be addressed.

We designed for execution by leveraging these insights to develop Gillette Guard from scratch, filtering every design and technology element through the eyes of the consumers and what they valued most. The result is a breakthrough shaving system designed to provide a safe, high-quality shave at an affordable price. The dramatically simplified product design uses 80% fewer parts than the two-blade razor, which led to a streamlined and lower-cost manufacturing process. We launched the product through print, digital, broadcast, store, and public relations—including live demos with Indian celebrities.

Gillette Guard is off to a great start and we're confident that this consumer-inspired innovation will improve even more lives in India and beyond. This is why P&G strategically disperses R&D resources across regions and close to—if not in—the markets we serve. This is critical to understand specific consumers and markets, have partnerships with and access to local innovation partners, and leverage the local talent base. Recent innovation center expansions completed in Beijing and announced in Singapore are evidence of this commitment—as are our refined and focused innovation centers in India, Japan, and over twenty other sites around the world.

[2] With its Asia-Pacific headquarters located in Singapore (also global business headquarters for the SK-II brand), P&G has announced an upcoming R&D Innovation Center for Beauty, Grooming and Corporate R&D by 2013. On the innovation front, P&G has also entered into a Master Collaboration Research Agreement with Singapore's Agency for Science, Technology, and Research. These strategic plans support P&G's manufacturing activities in Singapore—its first and only perfume plant for Asia, and a plant for manufacturing of PUR water purifier sachets for disaster relief.

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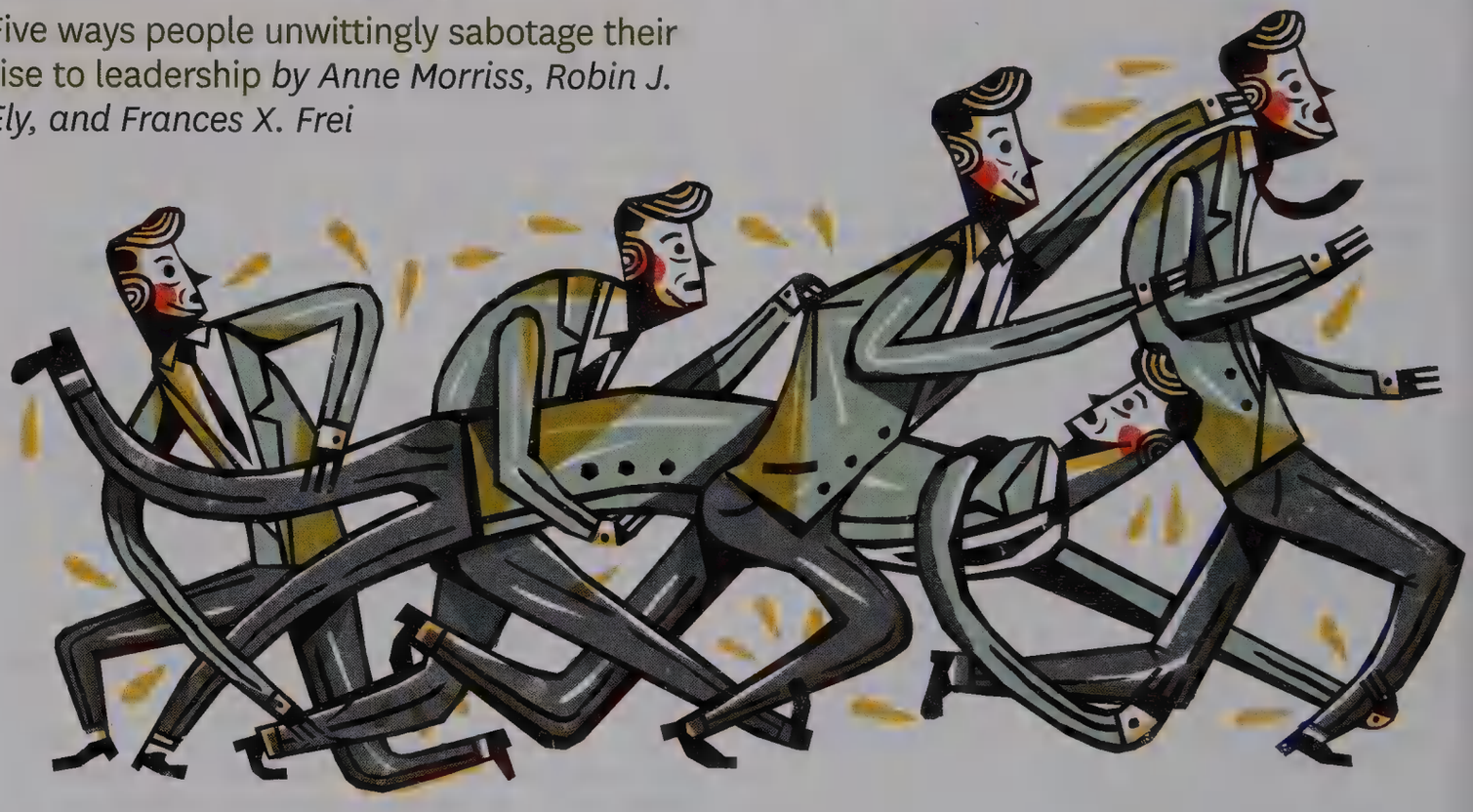
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Experience

MANAGING YOURSELF

Stop Holding Yourself Back

Five ways people unwittingly sabotage their rise to leadership *by Anne Morriss, Robin J. Ely, and Frances X. Frei*



From the world's poorest communities to the corner offices of its largest corporations, ambitious employees struggle with the same basic challenge: how to gain the strength and insights not just to manage but to lead. For more than a decade, from three different perspectives, we have been investigating what gets in the way. Robin conducts research on race, gender, and leadership; Frances focuses on coaching senior executives; and Anne works on unleashing social entrepreneurs around the world.

We've worked with hundreds of leaders in the public, private, and nonprofit sectors, in industries spanning more than 30 fields, and in more than 50 countries at various stages of development. Amid all the diversity, one very clear pattern has emerged: Organization builders, fire starters, and movement makers are unintentionally stopping themselves from becoming exceptional leaders. As a result, companies aren't getting the best from their people, and employees are limiting their opportunities.

Why does this happen? We've identified five major barriers.

BARRIER 1

Overemphasizing Personal Goals

True leadership is about making *other* people better as a result of your presence—and making sure your impact endures in your absence. That doesn't mean leaders are selfless. They have personal goals—to build status, a professional identity, and a retirement plan, among other things.



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But the narrow pursuit of those goals can lead to self-protection and self-promotion, neither of which fosters other people's success.

One leader we studied fell into this destructive behavior after a long, successful run at a number of software companies. Troy's bosses had always valued his drive and accountability. But when customer complaints began pouring into the service division he was managing, he pinned the blame on the "mediocrity" of the product development division, claiming that his team had to support an inferior product.

Troy's COO disagreed and began to hint that Troy's job was on the line: After all, the complaints had started accumulating on his watch. To shore up his position, Troy started working to win over senior colleagues one by one—"picking them off," as he put it—by asking for feedback on his performance. His strategy worked to some extent. Senior management recognized that he was committed to improving his leadership skills. But the customer service problems just got worse. People began trashing the company on influential blogs, and demands for refunds kept rising. The more Troy worked to save his job, the harder his job became.

Troy had a leadership breakthrough when one of his service representatives asked for help resolving the growing conflict with the product development team. The rep's despair triggered a shift in Troy's thinking—away from worrying about his own position and toward healing the split between the two divisions. Troy hosted a series of cross-team meetings and made sure that both groups felt heard. By the third meeting, the teams were brainstorming about ways to solve the service problem together, by improving the software and helping customers learn how to better use it.

Like other effective leaders, Troy changed his focus from protecting himself to supporting the members of his team and making sure that customers were happy. Within a few weeks, demands for refunds began to decrease, even though the company hadn't yet made any upgrades to the product.

The decision to focus on others can feel dangerous. It forces you to take your eyes off your own welfare and to stop scanning the horizon for predators. Risk aversion is a protective mechanism wired into our DNA; that's why security concerns generally trump impact. But all breakthrough leaders find ways to tame their security impulses. Most are amazed by the energy and meaning they discover when they no longer define themselves by their personal needs and fears.

Making other people a priority is perhaps most challenging for emerging leaders—especially women and minorities, who may feel heightened pressure to protect their interests in a world that seems (and often is) rigged against them. When societal attitudes contain built-in questions about your competence, it takes a lot of energy to keep trying to prove those attitudes wrong.

We don't underestimate this challenge. But if your goal is to lead, our advice is the same no matter who you are: First, *get over yourself.* Start with a commitment to make another person, or an entire team, better—and then go back for the skills and resources to pull it off.

BARRIER 2

Protecting Your Public Image

Another common impediment to leadership is being overly distracted by your image—that ideal self you've created in your mind. Sticking to the script that goes along with that image takes a lot of energy, leaving little left over for the real work of leadership.

There are more-nuanced costs as well. Once you've crafted your persona and determined not to veer from it, your effectiveness often suffers. The need to be seen as intelligent can inhibit learning and risk taking, for instance. The need to be seen as likable can keep you from asking tough questions or challenging existing norms. The need to be seen as decisive can cause you to shut down critical feedback loops.

One woman we interviewed, Anita, was an executive vice president in charge of the regional performance of a large retail company. The public image she'd created—tough, decisive, analytical—had been a powerful instrument in advancing her career. But it left little room for her humanity—an essential part of the leadership equation.

Anita thought that using intuition was intellectually lazy; she was known for the phrase "Show me the data." When in-store analytics suggested that the company gained little advantage from long-term employees, Anita ordered some store managers to replace experienced salespeople with lower-paid part-timers. The experiment reduced payroll costs, but it wreaked havoc on the culture and service experience in those stores—an outcome the data didn't immediately reveal.

The rep's despair triggered a shift in Troy's thinking—away from worrying about his own position and toward healing the split in the company.

Store managers tried to communicate their frustration to Anita, but the interactions invariably went badly. She pushed back on any concerns that weren't supported by numbers and recklessly concluded that her managers simply feared change. Their resignations started to roll in. Like many leaders, Anita had decided she could be tough or empathetic—but not both. She was unable to hear feedback, particularly from people below her, or to risk looking bad by making a high-profile course correction. And so she lost some of the company's best managers.

Once the turnover on her team reached 50%, however, Anita decided she had to take action. Inspired by an exercise in

Leadership Diagnostic: Are You Having Maximum Impact?

For most of us, the high-impact leader lurking inside comes out only on our best days. If you find yourself in this category—if you're not getting the leadership traction you want—ask yourself these questions. If most of your answers are "no," you may be getting in your own way.

Overemphasizing Personal Goals

Do I spend most of my time as a manager thinking about what other people in the organization need to succeed?

Does the "best version" of my employees show up in my presence?

Does their best version endure in my absence?

Protecting Your Public Image

Do I ever stop monitoring myself and simply do my job?

Have I been willing to "look bad" in the service of my team or organization?

Do I explicitly model the attitudes and behaviors I want others in my organization to adopt?

an executive education program she'd attended, she thought about teams she'd been part of that had worked together well. She then spoke with some of the people involved in an attempt to figure out why. Her conversation with her high school volleyball coach rattled her. He gave this advice: "If you want your people to care what you think, first make it clear that you care what *they* think." Within a few days, Anita reached out to one of the managers who had just resigned, a woman with a decade of experience making retail spaces work. She invited the manager to come back and help her repair the damage. Their collaboration was a professional turning point for Anita.

This type of journey is not uncommon. At some point in their leadership trajectory, ambitious people must choose between image and impact, between looking powerful and empowering others. They must choose, in effect, between impersonating a leader and being one.

BARRIER 3

Turning Competitors Into Enemies

One particularly toxic behavior is the act of turning those you don't get along with into two-dimensional enemies. Distorting other people is a common response to conflict, but it carries significant leadership costs. It severs your links to reality, making you reliably incapable of exerting influence. As you turn others into caricatures, you risk becoming a caricature yourself.

Consider Sarah, the COO of a global medical devices company. She specialized in integrating acquired businesses, and she was unambiguously great at her job. But she became easily frustrated by the "incompetence" of coworkers, including Max, the CFO. Sarah was quick to dismiss his abilities, having decided that he was out of his league and held his position only because he fawned over other senior leaders, particularly the CEO. She began to dislike everything about him—his voice, his ridiculous cufflink collection, his goatee.

Sarah started to rethink her judgment only when she was seated next to Max on a flight from London to the U.S. Forced to engage, she learned the reason for his apparent sycophancy—he was concerned about the CEO's credibility with investors and senior managers. By the time the plane landed, Sarah and Max were not only mapping out a plan to present the CEO more effectively but also talking about working together on business opportunities in Asia. Just as important, the conversation made Sarah realize that her hastily formed aversion had caused her to miss out on valuable chances to collaborate with a worthy colleague.

Circumstances forced Sarah to humanize Max, but we recommend a more proactive approach. Take a hard look at how you interact with colleagues whose agendas seem opposed to your own. Recognize that these colleagues are real people who may even become your allies.

BARRIER 4

Going It Alone

Most people opt out of leadership for perfectly good reasons. The road, by definition, is unsafe. It leads to change, not comfort. Troy, the software service division manager, found it deeply unsettling to try working in a brand-new way. Eventually, though, he learned how to cope with his fears: by relying on the advice and support of select friends and family members. We call these people "the team."

Find the people who believe in your desire and ability to lead. Fall in love with them. Or at least meet them for drinks on a regular basis.

Troy's team played a key role in his shift from focusing on his own career to helping his colleagues succeed. After more than a few sleepless nights, Troy decided to host a casual dinner for the people whose opinions he valued most: a sister, two friends from college, and a software entrepreneur he'd met at a recent Ironman competition. Halfway into the appetizer course, he put aside his pride, described his problem, and asked for advice.

Turning Competitors Into Enemies

Is it rare for me to feel defensive, insecure, or judgmental?

Is it rare for people to feel defensive, insecure, or judgmental around me?

Is my environment generally free of people I can't stand to be around?

Going It Alone

Do I have a core group of people who help me make important decisions?

Do I have people around me who can handle both my audacity and my insecurities?

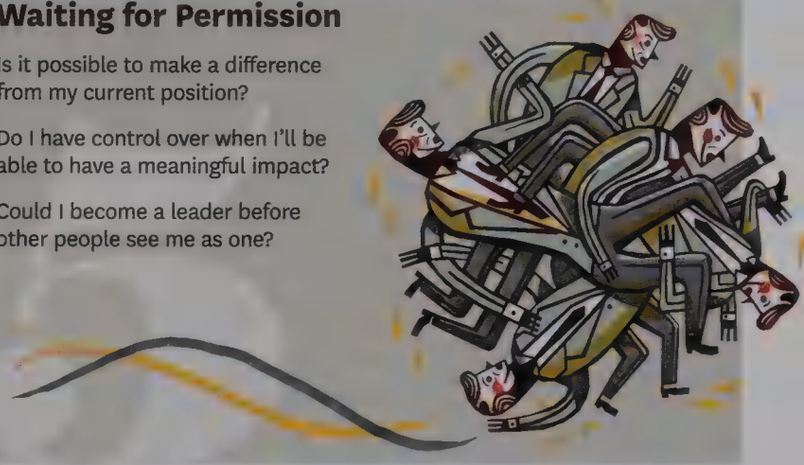
Do the most important people in my life participate in my leadership dreams?

Waiting for Permission

Is it possible to make a difference from my current position?

Do I have control over when I'll be able to have a meaningful impact?

Could I become a leader before other people see me as one?



His new triathlete friend, Raj, pushed Troy to stop worrying so much about his own job and instead try to break down the organizational silos that were making his life difficult and threatening the company as well. Troy initially resisted the idea, but the next day he decided to change his behavior according to what he called "Raj's intervention." The collaborative culture he created in his division and with the product development division became a model for other groups in the company. To this day Troy continues the monthly dinner ritual so that he and his "team" of family and friends can keep sharing problems and ideas.

We heard similar stories from other effective leaders. Almost all of them have a strong team that helps provide perspective, grounding, and faith. Your team members can be family, colleagues, friends, mentors, spouses, partners. The litmus test: Does the leader in you regularly show up in their presence? Find the people who believe in your desire and ability to lead. Fall in love with them. Or at least meet them for drinks on a regular basis.

BARRIER 5

Waiting for Permission

Like risk aversion, patience can be a valuable evolutionary gift. It's a main ingredient in discipline and hope. It helps us uncover the root cause of problems. It keeps us from hurting someone at the DMV.

But patience can be a curse for emerging leaders. It can undermine our potential by persuading us to keep our heads down and soldier on, waiting for someone to recognize our efforts and give us the proverbial tap on the shoulder—a better title and formal authority.

The problem with this approach is that healthy organizations reward people who decide on their own to lead. Power and influence are intimate companions, but their relationship isn't the one we tend to imagine. More often than not, influence leads to power, not the other way around.

Most of the exceptional leaders we've studied didn't wait for formal authority to begin making changes. They may have ended up in a corner office, but their leadership started elsewhere. In one way or another, they all simply began to use whatever informal power they had.

A personal trainer named Jon was in the middle of a workout session when he made the decision to lead. One morning, while he was trying to help a client lose her post-pregnancy weight, his mind kept wandering to a teenager he knew, and especially to worries that he might have joined a gang. In the middle of counting crunches, Jon realized he wanted to do something different with his life.

He sketched out his vision that night. He knew that weightlifting could appeal to young people at risk for gang involvement, so he decided to start a program that would offer them physical empowerment, independence, and community, and help them build self-esteem. Two years later InnerCity Weightlifting was serving more than a hundred kids in East Boston. Its gyms are among the few places in the city where rival gang members come together peacefully. Jon is now poised to expand the concept to other cities.

Jon's career change was not a logical pivot, at least not from an outside perspective. He was young, he was inexperienced with youth development programs, and he'd grown up with limited exposure to urban life. His friends and family thought he was crazy to give up his lucrative personal-training practice for what seemed to them a pipe dream. But Jon was impatient, unwilling to wait until he'd gained experience and legitimacy. He went for it anyway, and the program's early results gave him enough influence to recruit students, schools, parents, and funders.

Jon's story holds a lesson for every aspiring leader: You must simply begin.

Our Closing Plea

We're sharing this research because we're quite selfishly invested in having you get out of your own way. We want to live in a world—we want our children to grow up in a world—in which your talents are fully unleashed on the issues that matter most. You should learn to recognize and overcome the self-imposed obstacles to your impact. The rest of us need you on the front lines, building better organizations.

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Crucible

Transformative events that shape leaders

Surviving Twin Challenges—At Home and Work

Lois Quam had three babies and took on two high-profile jobs—within 23 months. But she found that the family demands she faced made her a better manager. *by Alison Beard*

The morning after Lois Quam gave birth to her first child, Ben, the chief of staff to the governor of Minnesota called to ask if she would chair a new state health care reform commission. She said yes and used her six-week maternity leave from UnitedHealthcare, where she was research director, to set up hearings. Suddenly, at age 28, she was a working mother with two big jobs, juggling legislative sessions, business meetings, and baby rearing.

Less than three years later, shortly after she'd had twins Will and Steve, Quam was offered another high-profile opportunity. Her boss wanted her to run UnitedHealthcare's public-sector services division. This time, she said no. "It was so overwhelming with twins. You can't pretend it doesn't make a difference. So I said, 'I'd really like to do this, but my primary focus for this period of my life is my sons.'" She remembers thinking, "This is going badly. It isn't strategic to be so blunt." But her boss surprised her. "He said, 'It's not a job that pays by the hour. You do it in a way that works for you, and if it doesn't for me, I'll tell you.'"

Looking back, Quam describes his reaction as an "amazing gift"—not because it persuaded her to take a position that would propel her to the top of her industry but because it affirmed her instincts about the best way to balance career and family. At work, her colleagues would see that she was a committed mom. And at home, her husband and sons would know how much she valued work. By embracing both parts of her life, she would become more focused and effective in each.

First Steps

As one of four children raised by first-generation Norwegian-American parents in rural Minnesota, Quam had always wanted to be a mom. She married her husband at 23 and started planning a family not long after. But her desire to work, to lead and make a difference, was just as powerful. As a teenager, she was active in Lutheran Church youth groups. At Macalaster College, she majored in political science. And after graduation, she studied at Oxford University as a Rhodes scholar.

Quam returned to St. Paul, hoping to work for the state Medicaid program, since early experiences as an asthmatic child had stoked an interest in health care. But circumstances were tough. "We were living in a friend's apartment, driving my grandmother's car, and trying to pay my husband's law school bills," she recalls. "So I went into the business world."

When she accepted her job at UnitedHealthcare—at that time a $440 million company—she was not yet pregnant with Ben. By the time she started, she was. Still, she says, "everyone was supportive," and the pregnancy was an easy one. She worked until the Friday just before her due date, had Ben on a Sunday, and felt well enough on Monday to call the office. When she did, her assistant was



breathless. The previous month, Quam had interviewed to be on the Minnesota Health Care Access Commission, building on work she'd done for the state's Children's Defense Fund, and Governor Rudy Perpich's office had called three times that morning. Four days later, Quam put on her most respectable maternity dress and met the governor at a nearby state fair to accept the chairwoman appointment. "We were praying it would go fast so she could make it back in time for Ben's next feed," Quam's husband, Matt Entenza, recalls.

Quam spent the next few months hiring commission staff and outlining a process by which she thought she could win broad-based support for reform. And she brought Ben to nearly every meeting. Perhaps some people thought less of her for working with a bassinet by her side. But rather than feeling "aggrieved," Quam saw it as an opportunity, a chance to "make headway fast." "I was underestimated," she says, "which gave me some running room."

By October, she had also returned to UnitedHealthcare, leaving Ben with Entenza, who had 12 months off before starting a federal clerkship. Over the next year, she found a happy balance between her job, the government work, and her family. But then, in late 1990, Quam became pregnant again—this time with twins. "I felt different immediately—very exhausted," she says. "I remember sitting in my office and being tempted to go take a nap in my car." Yet she pressed on, working full time, pushing the commission's proposal through the state legislature, and making time for Ben and Entenza at night.

The multitasking came to an end on June 3, 1991, when Minnesota's new governor vetoed the bill and, hours later, Quam went into premature labor. Doctors managed to stop it—the babies were only at 31 weeks—but they put her on bed rest. "I had to lie on my left side and only go between the first and second floor of my house once a day," Quam remembers. Communicating by telephone and fax (this was before e-mail was common), she did stay involved with the commission, meeting with executive director Jim Koppel to craft a postveto strategy and, with her office, working on research articles. "I tried to do it in a way that allowed [things] to progress without my day-to-day engagement," she explains. "My overwhelming concern was that the babies be healthy."

Will and Steve were born on July 23, at 38 weeks, weighing 8 pounds and 7 pounds. "That's been my greatest achievement—no question," Quam says.

A New Balancing Act

Still, the twins' arrival opened up a host of new anxieties: "How do I reenter life? Can I stay on the track I'm on?" Quam remembers thinking. "I'm the only woman in my family to work. My mom stayed home; my sister and sisters-in-law all do.

And I wanted to be a very involved mother. But I also wanted to contribute to building other really important things. When I came off this hard pregnancy with three little people to care for, I had to figure out what I was going to do differently to be true to what I wanted for me."

She took eight weeks' maternity leave before going back to both jobs: managing research at UnitedHealthcare and trying to revamp the health care legislation so it would be accepted. (Entenza, whose clerkship had ended, stayed home with the twins for 10 months, then went to work in the Minnesota attorney general's office.)

The next two years at home were filled with sleepless nights ("If the kids woke up before 3 AM, I got them; if it was after 3, Lois did," Entenza says), hospital visits (Steve and Ben had asthma problems), and the general chaos of life with three small boys (piles of cloth diapers, Legos on the floor, juice stains on the couch). "We were pretty ragged," Entenza admits.

At work, however, Quam remained a model manager, accepting her promotion and then laying the groundwork for what would become Ovations, a UnitedHealthcare division employing 20,000 people and generating $32 billion in revenue when she left it. "Going back to work when she had these babies had to be an emotional stress," says colleague Marcia Smith, who also has twins. "But Lois was calm, supremely organized. You didn't pick up on any angst."

Her fellow commissioners tell a similar story. "I recall the twins, but I don't recall it impairing her in any way," says George Halvorsen, now CEO of Kaiser Foundation Health Plan and Kaiser Foundation Hospitals. "She was very collaborative, and she worked extremely hard." The result of that effort was MinnesotaCare, legislation enacted in 1992 that became a model for other states.

Life Lessons

So how did Quam do it? "There were times I was really tired and thought, 'Should I take a break?'" she admits, "but my husband reminded me that if you're home with three kids, you're tired, too. He said, 'You've got a lot to contribute. You enjoy working. Let's just think about what we have to change to make this work.'"

Her first strategy was to focus on big-picture goals. At home, her main priority was to be an engaged mother and wife with a healthy, happy family. To that end, she started work later than many office-mates, left earlier, never worked weekends, and was always available in case of emergencies. ("There were days I would get to work and turn right around because someone was sick.") At work, her ambition was to build a business to scale by understanding how UnitedHealthcare could help government programs succeed. So she started each morning not by returning messages but by sitting down with tea and a notepad to think about key issues: opportunities, risks, recruitment, retainment, next steps. Koppel says she brought the same focus to MinnesotaCare. "I have many memories of Lois saying, 'How do we get this done?'"

> Quam's candor was unusual; "work/life balance" had not yet become a corporate buzzword.

Two other tools that served Quam well were division of labor and delegation. If she cooked, Entenza did the dishes. If she paid the bills, he picked up the toys. Friends and family helped with babysitting, but the couple also used all their savings to pay for a full-time nanny, a college student errand runner, and conveniences like grocery delivery (though a professional cleaning service was deemed too much of a luxury). Quam took the same approach at UnitedHealthcare. "In every case, I questioned, 'Does this require me?'" she explains. "I might send a team member to a key meeting that my peers would do themselves because the boys were sick or I didn't want to be away another night." Yet that made her a more popular boss: "People wanted to be on my team because they got a lot of opportunity."

Quam's last rule of thumb was to be honest about who she was and allow her disparate worlds to overlap. So, just as she brought Ben to commission hearings early on, she started taking business trips with one twin in tow, partly to save Entenza the pain of being home alone with three boys, but also to do some one-on-one mother-son bonding, and, later, to expose her children to her work. (A corollary rule was that if she traveled alone, she had to return well rested.) On the job and in public forums, Quam also frequently talked about being a parent. It was a way to engage people on a personal level and encourage them to keep thinking about the importance of affordable health care, particularly for kids. Smith notes that this candor was unusual at the time; "work/life balance" had not yet become a corporate buzzword. "Lois carved that out for herself," her colleague says. "Although her career became just huge, if she was asked to choose, you always knew what she would say."

Quam's oldest son is now 21; the twins are 19. Having left UnitedHealth Group in 2007 and done an 18-month stint overseeing investment bank Piper Jaffray's environmental and health care division, she now runs her own company, Tysvar, an incubator for "new green economy" and health care reform businesses. Looking back on her time as a young working mother, Quam acknowledges that she started out with the goal of "just making it." "It was a very tough time," she says. "But I was forced to learn things that made me more effective. It was the experience that should have made it impossible for me to become a CEO. But it actually gave me the remaining skills I needed."

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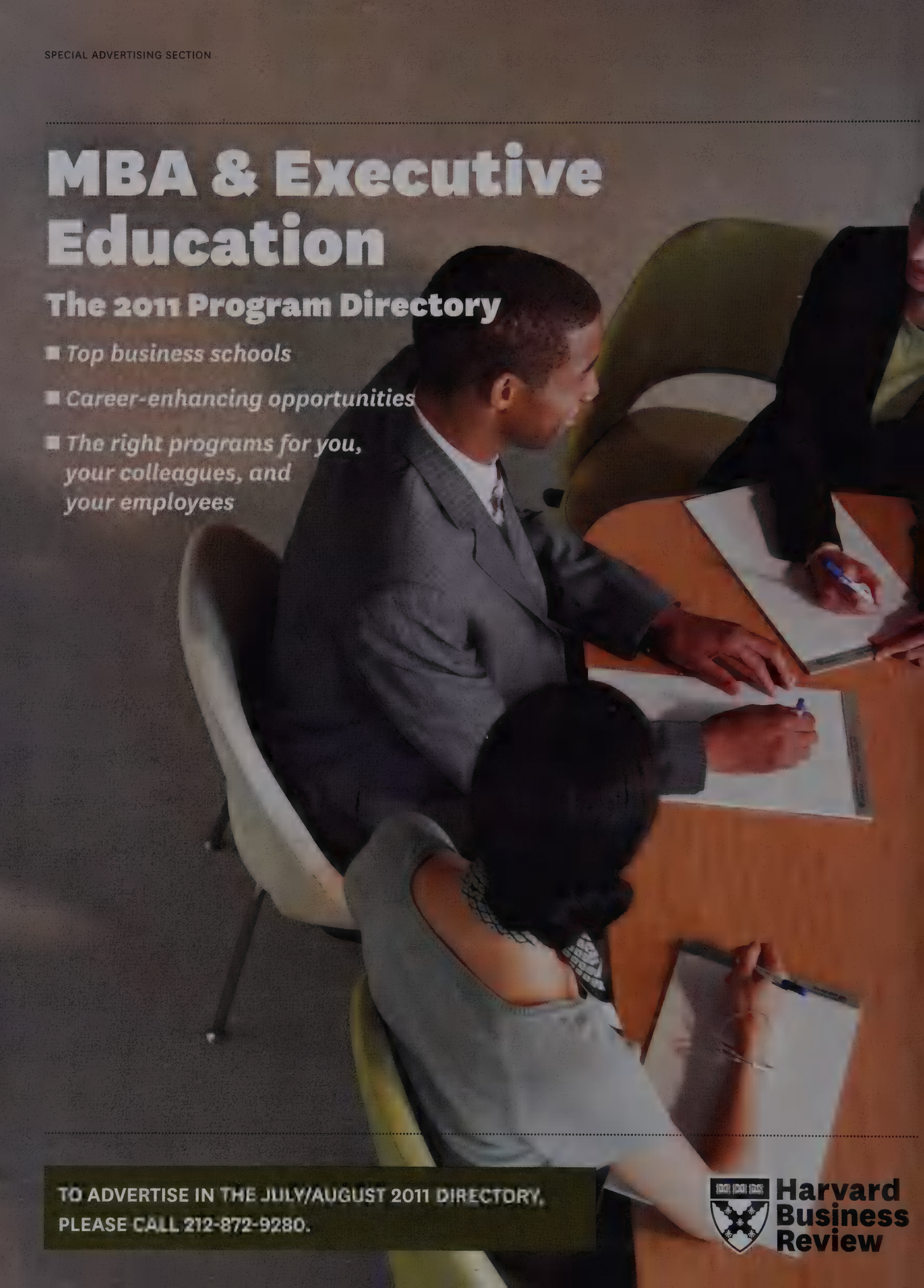
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Harvard Business Review

The Many Twists and Turns of Global Executive Education

BY JANICE FIORAVANTE

IF YOU THINK OF global executive education as bringing managers from locations around the world onto the main campus of a top business school, you are only partly correct. There's no single model, no "right" way to set up shop.

The preset menu of subjects for competency, leadership, and values that attracts individuals worldwide, referred to as open enrollment, is just one choice; multinationals and B-schools work in concert in a variety of flexible ways to meet companies' needs though customized programs, stretching schools' concepts of what they're offering.

At Harvard Business School, on-campus programs include a large number of non-U.S. participants. "For fiscal 2010 — July 2009 to June 2010 — 8,670 executives came through Harvard's executive ed programs; 63 percent were non-U.S. managers," says Charles Breckling, managing director for executive ed marketing. "That's significant — nearly two-thirds of the audience is international; we see ourselves as a global institution." At the other end of the spectrum and yet next door at Northeastern University in Boston, Thomas Moore, dean of the College of Business Administration, views executive ed from a highly customized stance. "We want to solve companies' problems and be held accountable for results, so we collaborate. We came up with a global platform that can be modified to local executives' needs."

When Northeastern alumnus Peter Lynt, now at IBM, discussed a huge churn of high-quality talent at IBM in India, "we suggested an online executive MBA to create stickiness and demonstrate IBM's support of their careers," says Moore. IBM reports that retention levels rocketed to three times what they'd been. The program's being rolled out to Shanghai next week, the Philippines in January, and then Egypt. "If an online program on the other side of the world means our faculty is teaching from midnight to 5 a.m., we're ready to deliver," says Moore. For IBM, it means managers don't have to be away from jobs due to travel time.

As ideas of education are in flux, morphing from all-knowing lecturers to facilitators, how to best deliver content and what the content itself should be are being challenged. And this mirrors corporate structures — finding out how to work around traditional business unit silos and get line managers around the world to communicate across regions. Being mired in worldwide recession showed how connected global economies really are.

To foster cohesiveness, William Hamilton, chief learning officer for the Americas at Ernst & Young, gathered 3,000 managers from Canada to Argentina in Orlando, Florida, to motivate them to operate similarly, using learning to get managers on board. "Part of globalization at E&Y — whether in Los Angeles, London ,or Mumbai — is that it has to look and feel like the same firm," he says. "An audit looks the same globally; the local regulations are different."

There's huge value in managers interacting with one another. And so E&Y taps Harvard for strategy content and The Kellogg School of Management at Northwestern University for negotiation. "We choose programs with a strong core, customized specifically for us," says Hamilton. "One of the key benefits of this global program is the opportunity individuals have to create new relationships with peers around the world." Today, global executive ed means a series of partnerships, alliances, and joint ventures, often in multiloca-



tion campuses. Harvard has put its brick and mortar into seven research centers located in the U.S., South America, Asia, and Europe. "This allows us to facilitate company research and to maintain relationships with companies locally; our faculty works with the research staff so that the curriculum is very global," says Breckling, noting that "last year 150 case studies were written from 29 countries."

Global, regional, local

Kellogg has actively pursued partners and joint ventures, offering an executive MBA (EMBA) — for mid-career executives — for about 15 years and taking it global by using network schools. One example is Hong Kong, where Kellog offered an MBA jointly with the Hong Kong University of Science and Technology (HKUST) Business School, and its own classrooms, designated faculty, with space for joint programs, says Stephen Burnett, associate dean and professor of marketing. The program attracts people from Japan, Thailand, mainland China, and the Philippines. Students spend half their time in Hong Kong, half on the Allen campus in Chicago.

Executive ed is moving to where students can study on all the campuses a business school provides. Kellogg's curriculum is patterned on its domestic EMBA, using network schools for electives all over the world, "so we might teach intellectual property in Tel Aviv," Burnett explains.

Most classes are taught in English with some non-degree programs translated: even B-schools in India and China use English. Kellogg offers 25 percent custom non-degree, 25 percent open enrollment, and 50 percent EMBA. Most schools still favor face-to-face teaching, sending course materials online and using social networks for connecting students.

The Wharton Business School, like Harvard, doesn't go the dedicated facility route but partners and develops alliances with local schools, giving faculty at each school an opportunity for peer-to-peer interaction. "We use faculty that have practiced in India, are familiar with India," says Martin Hackett, managing director of open enrollment programs.

Wharton was a founding partner, Hackett says, of the Indian School of Business (along with Kellogg), Singapore Management University, and Sasin Graduate Institute of Business Administration in Bangkok. Wharton's strategic alliance with INSEAD of France has existed for a decade and includes an exchange of students and faculty, as well as delivery of joint executive education programs. More than 45 percent of Wharton's custom clients are international, says Hackett.

Class both ways

B-schools outside the U.S. are busy recruiting American students as well. IESE Business School, based in Barcelona, opened its first U.S. outpost in New York this past March. Since 1963, when IESE went to Harvard for help to set up a two-year MBA program, it has been putting together alliances with other schools in the U.S. and around the world. "We draw on the strength of these schools in Latin America, Africa, the Philippines, China, and Egypt," says Eric Weber, associate dean and director of the New York center. "We can call our associate schools and overnight there will be a facility ready for our program."

Global executive ed programs continue their metamorphosis: top-ranked schools compete to expand in Asia, and now top Asian schools are directly recruiting American students; although the pendulum seems to have swung in the direction of customized programs — the prime example being Duke University Corporate Education set up as a 501(c)(3) tax-exempt nonprofit. Blair Sheppard, its head, has moved back to the Fuqua School of Business, intending to place schools around the world. This has the executive ed community scratching its collective head but standing back to see what's coming next — Sheppard is regarded as a visionary. The plan is for the Fuqua School to open five campuses, in Dubai, London, New Delhi, St. Petersburg, and Shanghai, returning to the brick-and-mortar template.

"Traditionally the West has been paternalistic toward developing leaders — this is the way you're supposed to do it — but now we know there's much to be learned from other parts of the world," says David L. Miller, vice president, North American business development at Duke CE.

"We're not bringing the U.S. to China or China to the U.S.; we're trying to define what good leadership is," says Jorgen Thorsell, executive vice president at Mannaz, a global executive development consultancy in Copenhagen.

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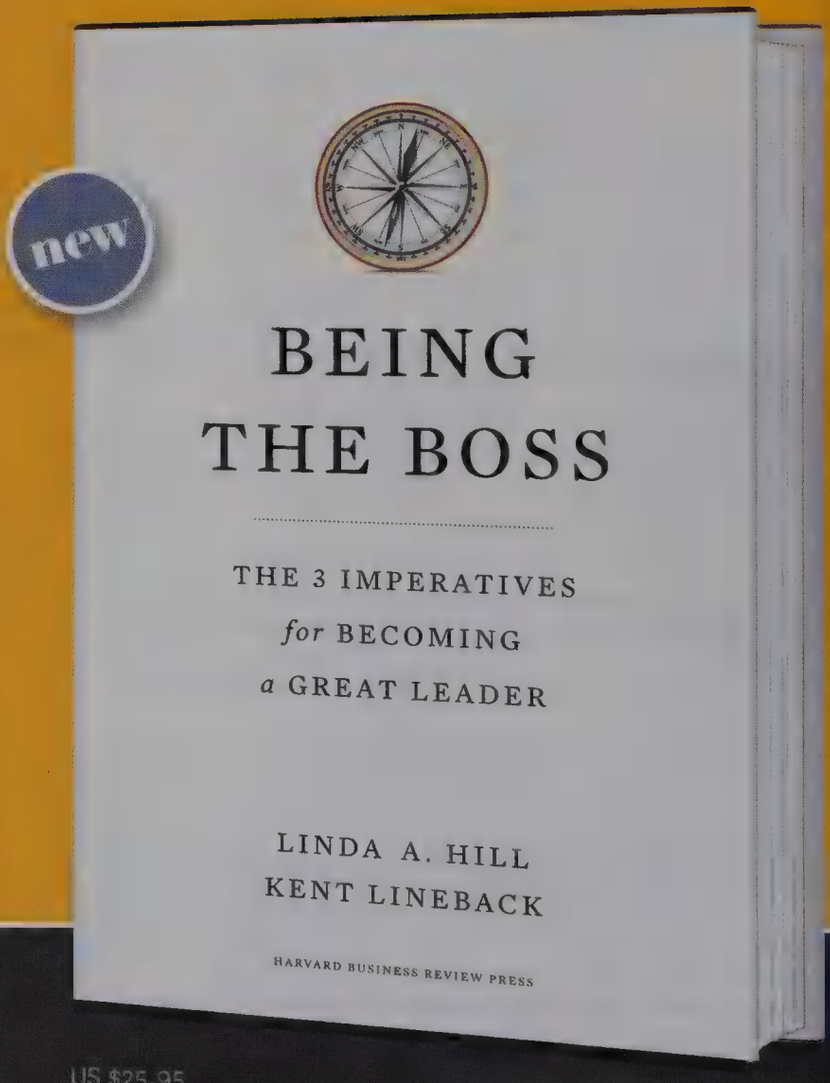
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Case Study

The owner of the prestigious Château de Vallois must decide whether to launch an affordable wine. *by Daniela Beyersdorfer and Vincent Dessain*

Preserve The Luxury Or Extend The Brand?

The Experts



Corinne Mentzelopoulos is the owner and CEO of Château Margaux, a first-growth wine estate in the Bordeaux region of France.



Philippe Sereys de Rothschild is the Vice Chairman of Baron Philippe de Rothschild, a family firm that manages the first-growth Château Mouton Rothschild, other estates, and branded wines.

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "Marketing Château Margaux" (case no. 507-033), by John Deighton, Vincent Dessain, Leyland Pitt, Daniela Beyersdorfer, and Anders Sjoman. It is available at **hbr.org**.

Gaspard de Sauveterre shivered as he stepped out of a side entrance to his château. While the late September days were still warm, he could feel autumn approaching. The 75-year-old owner of Château de Vallois, a famous wine-producing estate in the Bordeaux region of France, felt a familiar thrill. This was the season he and his team had worked toward the whole year; any day now the bell for the harvest, the famous *vendanges,* would ring. He quickened his pace down the long, well-kept alley through the wrought-iron gates to start his ritual morning walk through the vineyards.

He loved these hours when the rising sun bathed the misty landscape in shades of yellow and gray. The quiet, cool air cut through the thoughts that had been swirling in his head since his granddaughter burst into his study yesterday with an audacious proposal.

Claire de Valhubert had grown up on the estate but had moved to Paris following the sudden death of her mother, Gaspard's daughter, seven years ago. After graduating from one of France's elite *grandes écoles* she had worked for a top consulting firm before earning an MBA at Insead. Gaspard had expected her to come for the harvest, of course—she never missed it—but he had been surprised to hear about her plans to join the family business and radically change the centuries-old enterprise.

Claire had explained her idea as simply as possible. In her opinion, younger wine enthusiasts were being priced out of high-end French wines. And although she knew that de Vallois had been steadily profitable since the 1980s, she worried about what might happen if the estate allowed less-expensive, lower-quality winemakers, particularly those from outside the traditional wine-making regions of Europe, to capture and retain the next generation of customers. She wanted de Vallois to enter the "affordable luxury" market, selling

directly to customers, as some of the other top traditional Bordeaux estates had done.

When Gaspard mentioned the encounter to François de Sauveterre—his son, Claire's uncle, and the château's CEO—later that evening, François' first reaction was to raise a skeptical eyebrow. But he agreed to give his niece a hearing; after all, she had inherited her mother's 25% share of the estate, the same stake he held. Gaspard had the remaining 50%, and although François had taken over day-to-day operations five years ago, the elder de Sauveterre would certainly weigh in on any change in strategy, particularly one as dramatic as Claire's.

A Rare Vintage

Turning into the fields, Gaspard saw Jean-Paul Oudineaux, his estate manager, crouching over a vine and carefully examining its grapes. He had hired Jean-Paul, then a young agricultural engineer, 30 years ago after buying Château de Vallois.

The estate had fallen into a slow decline under its last owner, but together, Gaspard and Jean-Paul had restored it to its former glory. The essential ingredient had always been there: a *terroir* with the ideal soil and microclimate, which, according to the French, determines a wine's character. In a ranking of Bordeaux wine estates that recognizes their long-term track record in quality and reputation, de Vallois had in 1855 been classified as a *Premier Grand Cru Classé* (First Growth), which allowed the estate to command top prices for its wines.

Gaspard and Jean-Paul had overhauled the vineyards, improved the drainage, and subtly adjusted the blend. In time, the château produced perhaps the greatest of Bordeaux's five grands crus classés. It now sold about 150,000 bottles each year of its *Grand Vin du Château de Vallois,* a combination of carefully selected cabernet sauvignon, merlot, petit verdot, and cabernet franc grapes. The estate used the best of the remaining grapes to produce a second wine, the *Puiné,* averaging 200,000 bottles per year. The rest were

> "Vines are like children: They need to be looked after very carefully."

sold to other estates on condition that their origin would not be revealed. It was a good business and had kept his children comfortable, but he sometimes worried whether it would sustain future generations of de Sauveterres.

"I think we are almost there," Jean-Paul called out as Gaspard approached. "Just look at these grapes! This year could be even better than 2005."

Gaspard was not surprised; the weather had been warm and fairly dry all summer. "We could start picking Friday," Jean-Paul continued, "but I'd prefer to wait until after the weekend. The weather forecast is for a few showers and a drop in temperature, and I think that would add a little freshness." Plucking a few grapes himself, Gaspard concurred.

As he felt their tannic sweetness tease his palate, Gaspard asked Jean-Paul if he had seen Claire. Jean-Paul smiled, "No, but I'm sure I will. She hasn't been here the whole summer, so she'll inspect every corner of the place to make up for it."

"Well, you'd better prepare yourself," Gaspard replied. "She wants to make a branded wine and sell it directly."

Jean-Paul sighed. "You know what I'm going to say. Vines are like children: They need to be looked after very carefully. It's the same with selection and blending. Without 100% dedication to excellence, you cannot make outstanding wine. We already do two wines. Isn't that enough?"

Trusting in Tradition

Later that morning, Gaspard picked up a set of ancient keys and descended to the cellars. He entered the vaulted first-year section, in which the best of last year's harvest was aging in neatly aligned oak barrels stamped with the château's emblem. Around 70% of this still-maturing wine had already been sold to specialist merchants called *négociants* under a centuries-old arrangement designed to let noblemen stay out of commerce. The négociants bought the wine a year before bottling and then sold it to distributors and importers. Visitors were always surprised when told they could not purchase a bottle of wine directly from the château.

Prices for fine wine fluctuated widely, depending on the quality of the vintage, the reputation of the producers and négociants, and the expected demand, and they were increasingly influenced by the opinions of expert critics. Château de Vallois collected between €100 and €450 up front for a bottle of Grand Vin, for which a U.S. customer, for example, might pay $999 now for delivery a year later. Some of Gaspard's fellow grand cru classé owners complained about the négociants' margins, but Gaspard accepted them. He knew he could rely on the négociants to buy up Château de Vallois' total output, even in bad years, in order to maintain the relationship. What's more, since growers were paid in advance, the income from the sale made financing production a lot easier.

Gaspard unlocked the door to the private cellar, which housed almost every vintage the estate had produced. As he strolled among the ceiling-high racks, he looked up at the last two bottles from 1848, both covered in dust.

"I thought you'd be here, Papa, " François said, walking in. "I wanted to talk privately. Claire's idea is not going to work. In a good year, we don't have enough grapes for a third de Vallois wine, so we'd have to buy more and make a branded wine. If word got out about that, people could start worrying that we're mixing those grapes in all our wines. Also, there are risks to marketing our wine ourselves. We can charge a high price for it because it's exclusive and customers can only get it through a few, up-market providers. If people think we need to push it, they might not be willing to pay so much."

"Claire has thought about that, too," Gaspard said. "She's thinking of keeping the new wine separate."



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François shook his head. "Well, that's no answer. You know some of the négociants may not like to see producers of grands crus classés adding branded wines. So not only would we have to invest in a distribution channel for which we have neither the experience nor the means, but we'd also be risking the goodwill of the people who sell the wine we're currently making."

Gaspard knew his son was a traditionalist. Although he himself still felt like a stranger in Bordeaux after three decades, François had become well connected through his marriage to the daughter of an important négociant family.

"You know, Cécile's family has been in the business since 1739," François pointed out. "They are as experienced in distributing wine as we are in making it. They take care of all the marketing, insurance, and transport stuff that we'd have to manage otherwise, and they can tell just where to draw the line between exclusivity and scarcity. They know to whom we should be selling and who to avoid. How would we even determine what price to set each year? Granted we might get bigger margins selling directly in a good year, but what are we to do in a bad one?"

A Case for Change

That evening, Gaspard walked up the main staircase and entered the *salon jaune*. The rich polish on the furniture glowed in the soft candlelight, and the crackling fire was piled high with vine branches that scented the air. He took a seat by the hearth and was reaching out to a dish of almonds on a side table when his granddaughter came in.

"Are you all right, *grandpapa?*" Claire asked, looking at him closely. "Am I first for once?"

Gaspard smiled, "It is good to have you back here, my child. Sit down, and tell me what you have been up to today." She was about to answer when François, his wife, and Jean-Paul came in together.

"We just heard the latest forecast and we've agreed to start the harvest on Monday," François announced. The three took their seats and Gaspard handed the almonds around. "I've asked for dinner in the kitchen tonight," he said. "It will be more intimate, and after all, we're *en famille.*"

The château's authentically preserved kitchen, with its enameled ranges and open fireplace, was certainly more intimate than the dining hall, but tonight's table was nevertheless dressed with flowers, starched linen, and fine porcelain. Each place was set with silver and four crystal glasses for the different wines that would accompany each course.

Gaspard could tell that Claire was eager to talk business from the moment she sat down, but she managed to contain herself until the main course. She took a sip of the 2001 Grand Vin that accompanied the soft *agneau de Pauillac* on her plate and turned to Gaspard. "Grandpapa," she began, "I know what you were thinking yesterday: 'Here she comes, her head all filled with business school nonsense.' But I really believe that we aren't realizing even half of what this estate is worth."

> "If we can make such great wine here, why not make a wine for younger people somewhere else?"

Seeing his son frown, Gaspard quickly replied, "Not at all. I may look like a dinosaur, but I am always open to new ideas. I'm sure your uncle agrees."

Sensing encouragement, Claire forged ahead. "I propose that we introduce a branded wine at a price of about €20 to €25 a bottle. Our first wine is way beyond what most people can afford, particularly the older vintages—even a bottle of the 2000 sells for about €1,000. And our second wine, at €100, is still too expensive for the average person, particularly younger people, to buy regularly."

She looked at François: "I know this would work only if we produce at least one million bottles, so we'd have to buy grapes. If you're uncomfortable with that, we could buy more land instead and grow them. We can't claim a Château de Vallois origin on this wine's label, but with Bordeaux grapes or land, we could at least state 'Bordeaux origin.' Good land here is expensive, but we could also buy overseas, like some of our competitors. Why not make a branded wine with California grapes and a label mentioning that our de Vallois team is in charge of it? Why shouldn't we capitalize on our brand? And if we can make such great wine here, why not make a wine for younger people somewhere else?"

She continued, "Of course, to do this we would need our own distribution channel. We know, in fact, many of our customers, particularly the specialized importers, from their château visits. For others we could set up our website to allow them to order directly. Many are already asking for this."

Claire paused to taste her wine and seemed bolstered by its elegant, balanced flavor.

"Finally, I know how we all feel about even the best New World wines—not aging well, too heavy, too fruity, no matter what Robert Parker says. But we can learn a lot from those producers in terms of marketing. They run great advertising campaigns and do market research, which means they can adapt quickly to changing tastes by changing the flavors they offer.

"I'm not suggesting that we meddle with our first wine, but with a branded wine we could be much more flexible, and that would give us a chance to attract younger consumers, get ahead of drinking trends, and make sure that when they're ready for more expensive wines, they'll come to us."

François pushed his plate away. "My dear, please don't take this badly," he began carefully. "I do consider how we can touch young customers and enhance our revenues—every CEO does. But I think you're completely misguided. We might

Case Study

not take full advantage of our reputation, but isn't that partly why we have such a good one? And why spend money on a whole marketing and distribution machine for a low-priced wine?"

Jean-Paul stirred uncomfortably. "Who will make this branded wine anyway?" he growled. "I have neither the expertise nor the interest in making fruity wines with other people's grapes."

Gaspard took advantage of the silence that followed to call a halt: "I think that's enough for now. Let's continue this discussion in the boardroom tomorrow."

Time to Harvest?

Gaspard found the boardroom empty when he returned from his walk the next morning. He had woken up early, replaying last night's conversation over and over in his mind.

His son was right to worry. The aura of exclusivity around the first wine could easily be destroyed if people started to think that the estate was tampering with it. But Claire had a point, too: They had gotten too caught up in their routine of creating the perfect grand cru classé. Well, if nothing else, he reflected, she was making them think and would be a good sparring partner for François in the years ahead.

The two were at loggerheads, but Gaspard had not completely retired yet. It would be up to him to cast the deciding vote.

Should Château de Vallois begin producing a more-affordable wine?

See the following two commentaries.

Daniela Beyersdorfer (dbeyersdorfer@hbs.edu) is a research associate at Harvard Business School's Europe Research Center, in Paris. **Vincent Dessain** (vdessain@hbs.edu) is the center's executive director.

The Experts Respond



Corinne Mentzelopoulos is the owner and CEO of Château Margaux.

THE DILEMMA presented in this case underscores a constant issue for those of us working in fine and rare wines, such as Château Margaux. Balancing the competing demands of growth and quality is never easy. Nevertheless, I would advise Gaspard de Sauveterre not to add a branded wine at this time, even though the market for fine wine is growing very fast, driven mainly by emerging markets such as China (where the demand is particularly remarkable) and India.

Château de Vallois benefits enormously from its *Premier Grand Cru* status and from the reputation of its *Grand Vin*. Because the grapes must come from the estate's classified plots of land, de Vallois can produce only a very limited number of bottles per year. At the same time, it must try to ensure broad distribution through the *négociants*. François de Sauveterre is right to point out that this restricted availability helps preserve the estate's exclusive image and that any attempt to change the traditional, albeit successful, way of doing things could easily alter the wine's perceived value in the eyes of both the industry and the consumers.

What's more, Jean-Paul Oudineaux already has his hands full maintaining the quality of the estate's intricate, highly complex, production process. The quality of each vintage varies with the climate, and even in an excellent year, planting, plowing, crop thinning, harvesting, blending, aging, and bottling all require very careful management and coordination to produce a truly first-rate wine. Any change in the conditions of the soil or climate—no matter how slight—or variation in the quality of the grapes, for example, will require timely adjustments throughout the year and subtle alterations in the final blend.

In addition, the estate's management has no experience in successfully launching and capitalizing on a brand with a lower price point. They do not know the mass-market segment of the wine business and its distribution channels, and they don't know this new segment's customers because they have always conducted business through the négociants.

Finally, if Jean-Paul were to take responsibility for producing a branded wine, he would necessarily have less time for tending his main responsibility, and the existing wines would likely suffer as a consequence. To avoid that result, the estate would, at the very least, have to recruit a new manager for the branded wine—which might lead the market to believe that the focus of the estate's proven expertise could be diverted from Château de Vallois itself. Besides, launching a new branded wine from scratch would constitute a significant investment.

Any attempt to change the traditional way of doing things could alter the wine's perceived value in the eyes of both the industry and the consumers.

Of course a wine-producing estate, just like any other company, has to protect its financial future. It's wise to periodically question the business model and examine opportunities as well as threats. Even estates that rely heavily on time-proven expertise, like ours, must constantly keep an eye out for new ideas, methods, and equipment that will help them remain at the top. Claire de Valhubert would be a valuable addition to de Vallois' management team in that regard, and Gaspard should certainly encourage her to join the business. But because the de Sauveterres operate in a high-luxury niche, they should refuse to transform the estate into a more industrial business and resist the temptation to add a branded wine for the mass market.



Philippe Sereys de Rothschild is the Vice Chairman of Baron Philippe de Rothschild.

SHOULD THE de Sauveterres explore new opportunities in the branded-wine segment? Absolutely. But they should proceed very carefully. Because first-growth and branded wines involve two entirely different markets, they must be managed completely independently. Nevertheless, many companies in high-end or luxury markets have successfully grown by branching out; my family's firm is one example. We have done so by clearly separating our estate wines (specifically the first growth) from our branded wines. In the current worldwide wine market, protecting the unquestionable quality and image of the first growths is paramount.

It is only natural for François to worry about eroding the de Vallois brand, since his responsibility is to make the best possible first-growth wine for the highly selective top end of the market. He should remain fully focused on that production and not lead the new venture, though he could oversee the work of the separate, branded-wine team to make sure that the new product is of very good quality.

Moreover, the prices for first growths have skyrocketed in recent years, partly because of the growing number of wine connoisseurs around the world and emerging wine markets, such as China and India. If we want to keep younger wine drinkers buying and consuming good-quality wines at affordable prices—and attract future high-quality-wine drinkers as well—then companies like ours, with superior reputations, must make good-quality branded wines available at competitive prices. They can be made under the umbrella of the original group, but the production and distribution chains must be clearly separated. One option is to create two discrete business units within the group.

If the family does decide to develop the branded wine, it will need to put in place a distinct marketing and distribution strategy. Given the estate's traditional first-growth positioning, the de Sauveterres will have to emphasize that the move will not compromise the *Grand Vin*. They could position their campaign, for example, as pursuing a mission to create a wine with the best relationship of quality to price so that members of the younger generation will start off drinking good products and then upgrade to more-expensive, luxury wines later on.

Companies with superior reputations must offer good-quality branded wines at competitive prices.

Marketing the new branded wine directly would give the de Sauveterres a better understanding of the wine market in general and how it might evolve. It would also help them learn about distribution, which could be useful if they want to continue growing their business in the future.

For the sake of harmony, I would advise Gaspard to encourage Claire to join the business; any family member who wants to do so should be allowed to find a position. However, she must build up and carve out her own area of responsibility, which in this case could be the branded wine.

Wine is an interesting product, and personal preferences can vary greatly. I often sample and enjoy wines from all over the world. And though, like the de Sauveterres, I prefer the fine old Bordeaux wines with length and full body, that does not mean that the more immediately seductive, New World wines are not worth making or that I shouldn't make them.

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WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

CHÂTEAU DE VALLOIS is suffering from a classic family business problem. Each member feels that he or she has the right to pull the business in his or her direction. Instead, they need a board of directors with a nonfamily majority, one that will create a complete business plan, not just agree or disagree on marketing a new wine.
Tony Gregory, *CEO, CODA Business Management*

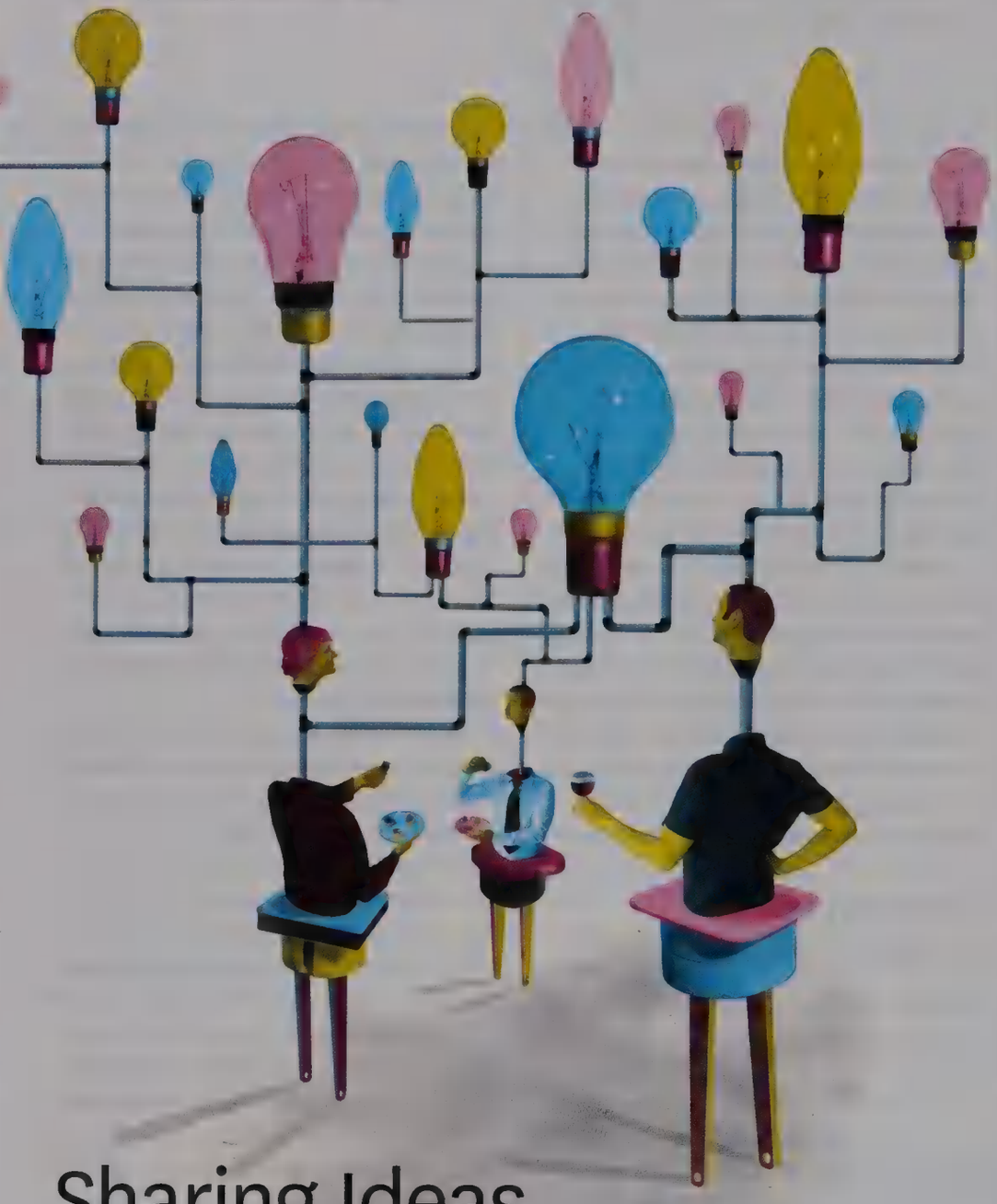
I WOULDN'T go from exclusivity to a wide market. Instead, create an even more exclusive wine, perhaps 5% of total production (but with higher margins), sold directly from the chateau, as a brand extension. Such a small quantity would neither require more grapes nor harm the *négociants'* business. Even better, the prestige of the whole de Vallois brand would increase because of the new wine's scarcity.
Alen Gojceta, *midmarket sales manager, IBM Croatia*

GASPARD SHOULD venture into the affordable wine category but via a subsidiary, with a professional CEO and managers. Claire is enthusiastic but not sufficiently mature as a businessperson; she could play a more suitable role, such as strategist. The venture should focus on younger and first-time buyers, as well as restaurants that cater to such clientele, in markets such as America, Latin America, southern Europe, and Asia.
Vivek Kochikar, *associate vice president and principal researcher, Infosys Technologies*

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Synthesis

A review of emerging ideas in the media



Sharing Ideas And Hors d'Oeuvres

Are high-end conferences like TED worth it?

by Jimmy Guterman

For decades, Richard Saul Wurman was the man in charge of TED, the pricey, invitation-only annual event where leaders in technology, business, entertainment, and design meet to trade ideas, make deals, and feel elite. He thought it up; he turned it into a must-go for a generation of inventors, disrupters, and corporate moguls; and, at a time when the event seemed past its peak, in post-dot-com 2001, Wurman sold it to a nonprofit foundation for a reported eight-figure price.

It's September 2010, and Wurman is onstage at BIF (Business Innovation Factory), another three-letter-acronym event held in Providence, Rhode Island, that follows the TED playbook: austere yet dramatic talks celebrating brilliance and iconoclasm, a mix of A-list speakers and unknown wonders, plenty of rhetoric about changing the world. Wurman is there, it seems, to drizzle some cynicism on these earnest proceedings.

Although TED has been more successful than ever in recent years under the direction of media entrepreneur (not editor in chief of *Wired*) Chris Anderson, Wurman seems to think it is broken. With amiable narcissism, he argues that TED's 18-minute talk format has become "ungenuine"; that the quality of attendees has declined ("There's always a seat for someone who's famous or rich enough"); and that a recent proliferation of independently produced TEDx events (Disclosure: I am a producer of one) has led to "a lot of very amateur stuff." He says emphatically: "What I created I need to destroy now."

It's easy to dismiss Wurman's crankiness, but it makes one wonder: Are the big idea-sharing events—not only TED but also its geopolitical cousin, the World Economic Forum, and even once-hip/now-mainstream industry conferences such as South by Southwest and the Sundance Film Festival—still living up to their promise? As they become more popular, do they become less interesting? Can they be elite and democratic at the same time? Can they retain an aura of specialness while simultaneously pursuing a strategy of ubiquity?

When I began attending TED, in 1997, it was hard to find information about the event. Although it was well established by that time, it still felt like a secret. Its website was purposefully light on information, and what happened in the halls of the Monterey Convention Center stayed in Monterey. No more. While the entrance fee for the main event, now held in Long Beach, California, every February, remains staggering (starting at $6,000 yet selling out more than a year in advance), it is difficult for anyone interested in ideas to avoid TED. In addition to hundreds of local TEDx's, there are now several other large TED events and more than 800 free "TEDTalk" videos available on the website. Despite its elitist core, the organization

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promotes "ideas worth spreading" and is determined to be as democratic as its business model allows it to be.

So TED is no longer an exclusive club when it comes to engaging with the broader organization or the ideas presented. But what about getting access to fellow attendees? As Matt Ridley put it so trenchantly at a TED event in Oxford, England, last year, TED is "where ideas have sex." It's where smart people meet other smart people and wind up collaborating on everything from predicting the next internet trend to distributing vaccines in Africa more effectively. You're more likely to get Bill Gates's attention by speaking to him in the buffet line than by calling the Gates Foundation and asking if the boss is in. Even a wallflower will emerge from these conferences with a richer collection of contacts. This is as true now as it was when I started attending. I've had interesting discussions with and heard impressive talks from former Nigerian finance minister Ngozi Okonjo-Iweala and novelist Kurt Andersen, astronomer Carolyn Porco and musician David Byrne. I've stood next to basketball player Kareem Abdul-Jabbar and asked dumb questions of both a Nobel laureate and an Academy Award–winning actress.

> **"What I created I need to destroy now."**
> Richard Saul Wurman, creator of TED, a must go for a generation of inventors, disrupters, and corporate moguls

What about the ideas themselves? Regardless of how widely they're eventually disseminated, are these concepts that will "change the world"—Anderson's oft-stated goal? Many of them should, but do they? There's no question that TED is a tremendous intellectual party, and its director has a curator's instinct for unexpectedly brilliant combinations. But it's hard to think of an idea born or developed at any of its events that has been a real game changer. (Yes, Al Gore's *An Inconvenient Truth,* which began its life as a TEDTalk, was a hit. But what exactly has it changed?) The biggest news out of last year's TED was not any of its ideas (one of the speakers, biochemist Mark Roth, presented evidence backing up his claim to have conquered death via suspended animation) but a minor controversy surrounding the typically provocative performance of comedian Sarah Silverman. A regional website's coverage of a recent TEDx appeared not in its news section but in its style section.

Other high-end conferences face similar issues. The World Economic Forum used to be a group of wonks working on policy; now it's a place to see Bono. Sundance used to be a magnet for truly independent filmmakers; now it is part of the major studios' launch strategies. Yet these events still serve a purpose. Even without the celebrity guests, they remain supreme networking extravaganzas. They continue to be a place for the cross-pollination of thoughtful (and sometimes groundbreaking) ideas. TED, more than the others, is still a place to find education and surprise—not only for the elites at the main event but also, once the talks migrate to the web, for the broader public.

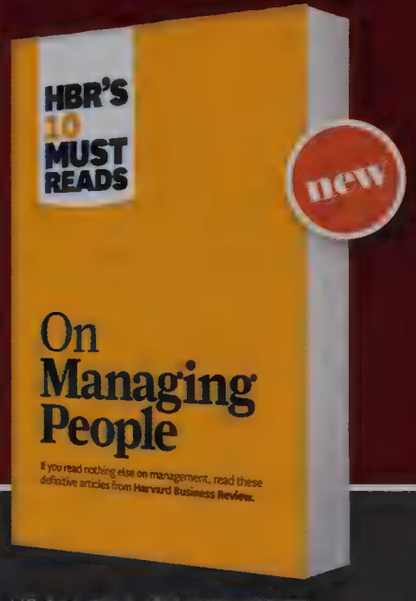
Back onstage in Providence, Richard Saul Wurman looks at the audience and says, "You are all stupid." The audience is quiet except for a bit of nervous laughter, but Wurman means it as a compliment, not an epithet—an argument that even elitists should welcome every talk with a beginner's mind. He adds: "What a joy not to know something and slowly fill it in." When he ran TED, that was what he hoped those attending would feel as well, and Chris Anderson's goals are similar: to help us all learn something and act on it. At a time when businesspeople and politicians pretend that they have it all figured out, ongoing education may be the greatest idea worth spreading.

Jimmy Guterman is a senior editor at *Harvard Business Review.*

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Executive Summaries January–February 2011

SPOTLIGHT ON BUSINESS MODEL INNOVATION



Companies are under pressure to change the way they do business. This collection of articles offers insights into what a business model really is, how to reinvent businesses in emerging markets, why change is so hard to achieve, and whether we've got the right investment models for our times.

ORGANIZATION & CULTURE

Reinvent Your Business Before It's Too Late

Paul Nunes and Tim Breene | page 80

To survive over the long haul, a company must reinvent itself periodically, jumping from the flattening end of one business performance curve to the rising slope of another. Very few companies make the leap successfully when the time comes. That's because they start the reinvention process too late.

Once existing business begins to stall and revenue growth drops significantly, a company has less than a 10% chance of ever fully recovering.

Accenture's Nunes and Breene, reporting on the results of their long-running High Performance Business research program, point to a striking difference between companies that have successfully reinvented themselves and those that failed. High performers manage their businesses not just along the growth curve of their revenues but also along three much shorter, though equally important, S curves: tracking the basis of competition in their industry, renewing their capabilities, and nurturing a ready supply of talent.

By planting the seeds for new businesses before revenues from existing ones begin to stall, these companies enjoy sustained high performance.

HBR Reprint R1101D

EMERGING MARKETS

New Business Models in Emerging Markets

Matthew J. Eyring, Mark W. Johnson, and Hari Nair | page 88

Many Western multinationals expect to find most of their future growth in emerging economies. But they have frequently struggled to exploit the opportunity, relentlessly cutting costs and accepting profit margins close to zero. The problem, say the authors, who are all with the innovation consultancy Innosight, is not that those companies can't create viable offerings but that simply transplanting their domestic business models to the new markets won't work. They must devise fundamentally new models—by identifying an important unmet job that consumers need to do; performing that job profitably at a price the customer will pay; and carefully implementing and evolving the model by constantly testing assumptions and making adjustments.

Drawing on their experience with investing in, incubating, and consulting for companies that have created 20 new business models in developing markets, the authors describe the vast potential demand represented by the "middle market" in emerging economies—the millions of people who have the desire and wherewithal to pay for goods and services, from refrigeration to clothes washing to money transfers, that will help them do the jobs better than any other current offerings.

HBR Reprint R1101E

STRATEGY & COMPETITION

How to Design a Winning Business Model

Ramon Casadesus-Masanell and Joan E. Ricart | page 100

Most executives believe that competing through business models is critical for success, but few have come to grips with how best to do so. One common mistake, the authors' studies show, is enterprises' unwavering focus on creating innovative models and evaluating their efficacy in standalone fashion—just as engineers test new technologies or products. However, the success or failure of a company's business model depends largely on how it interacts with those of the other players in the industry. (Almost any business model will perform brilliantly if a company is lucky enough to be the only one in a market.) Because companies build them without thinking about the competition, companies routinely deploy doomed business models.

Moreover, many companies ignore the dynamic elements of business models and fail to realize that they can design business models to generate winner-take-all effects similar to the network externalities that high-tech companies such as Microsoft, eBay, and Facebook often create. A good business model creates virtuous cycles that, over time, result in competitive advantage.

Smart companies know how to strengthen their virtuous cycles, undermine those of rivals, and even use them to turn competitors' strengths into weaknesses.

HBR Reprint R1101G

LEADERSHIP

The CEO's Role in Business Model Reinvention

Vijay Govindarajan and Chris Trimble | page 108

Fending off new competitors is a perennial struggle for established companies. Govindarajan and Trimble, of Dartmouth's Tuck School of Business, explain why: Many corporations become too comfortable with their existing business models

Corporations need to reinvent their business models to fend off new competitors.

and neglect the necessary work of radically reinventing them.

The authors map out an alternative in their "three boxes" framework. They argue that while a CEO manages the present (box 1), he or she must also selectively forget the past (box 2) in order to create the future (box 3). Infosys chairman N.R. Narayana Murthy mastered the three boxes to reinvigorate his company and greatly increased its chances of enduring for generations.

HBR Reprint R1101H

REINVENTION

When Your Business Model Is in Trouble

An interview with Rita Gunther McGrath | page 96

With product life cycles growing ever shorter and competition cropping up in unexpected places, nearly every industry is facing disruption. How can you tell if your model is running out of gas? For starters, if your next-generation innovations provide smaller and smaller improvements and your people have trouble thinking of new ways to enhance your offering. Pay heed to the signs and start experimenting with several new options until you find one that will turn your threat into an opportunity.

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The HBR Agenda



BREAKTHROUGH THINKING

The HBR Agenda: What Top Minds Will Focus On in 2011

page 47

HBR asked top management thinkers to share what they were resolved to focus on in 2011. Here are their answers: **Joseph E. Stiglitz** will be crafting a new postcrisis paradigm for macroeconomics whereby rational individuals interact with imperfect and asymmetric information. **Herminia Ibarra** will be looking for hard evidence of how "soft" leadership creates value. **Eric Schmidt** will be planning to scale mobile technology by developing fast networks and providing low-cost smartphones in the poorest parts of the world. **Michael E. Porter** will be using modern cost accounting to uncover—and lower—the real costs of health care. **Vijay Govindarajan** will be trying to prototype a $300 house to replace the world's poorest slums, provide healthy living, and foster education. **Dan Ariely** will be investigating consumers' distaste for genetically modified salmon, synthetic pharmaceuticals, and other products that aren't "natural." **Laura D. Tyson** will be promoting the establishment of a national infrastructure investment bank. **Esther Duflo** will be striving to increase full immunization in poor areas of India. **Clay Shirky** will be studying how to design internet platforms that foster civility. **Klaus Schwab** will be undertaking to create a Risk Response Network through which decision makers around the world can pool knowledge about the risks they face. **Jack** [redacted] will be working to instill a strong set of values in his 19,000 young employees and to help clean up China's environment. **Thomas H. Davenport** will be researching big judgment calls that turned out well and how organizations arrived at them. **A.G. Lafley** will be proselytizing to make company boards take leadership succession seriously. Eleven additional contributors to the Agenda, along with special audio and video features, can be found at **hbr.org/2011-agenda**.

HBR Reprint R1101B

The Big Idea



STRATEGY & COMPETITION

Creating Shared Value

Michael E. Porter and Mark R. Kramer | page 62

The capitalist system is under siege. In recent years business has been criticized as a major cause of social, environmental, and economic problems. Companies are widely thought to be prospering at the expense of their communities. Trust in business has fallen to new lows, leading government officials to set policies that undermine competitiveness and sap economic growth. Business is caught in a vicious circle.

A big part of the problem lies with companies themselves, which remain trapped in an outdated, narrow approach to value creation. Focused on optimizing short-term financial performance, they overlook the greatest unmet needs in the market as well as broader influences on their long-term success. Why else would companies ignore the well-being of their customers, the depletion of natural resources vital to their businesses, the viability of suppliers, and the economic distress of the communities in which they produce and sell?

It doesn't have to be this way, say Porter, of Harvard Business School, and Kramer, the managing director of the social impact advisory firm FSG. Companies could bring business and society back together if they redefined their purpose as creating "shared value"—generating economic value in a way that *also* produces value for society by addressing its challenges. A shared value approach reconnects company success with social progress.

Firms can do this in three distinct ways: by reconceiving products and markets, redefining productivity in the value chain, and building supportive industry clusters at the company's locations. A number of companies known for their hard-nosed approach to business—including GE, Wal-Mart, Nestlé, Johnson & Johnson, and Unilever—have already embarked on important initiatives in these areas. Nestlé, for example, redesigned its coffee procurement processes, working intensively with small farmers in impoverished areas who were trapped in a cycle of low productivity, poor quality, and environmental degradation. Nestlé provided advice on farming practices; helped growers secure plant stock, fertilizers, and pesticides; and began directly paying them a premium for better beans. Higher yields and quality increased the growers' incomes, the environmental impact of farms shrank, and Nestlé's reliable supply of good coffee grew significantly. Shared value was created.

Shared value could reshape capitalism and its relationship to society. It could also drive the next wave of innovation and productivity growth in the global economy as it opens managers' eyes to immense human needs that must be met, large new markets to be served, and the internal costs of social deficits—as well as the competitive advantages available from addressing them. But our understanding of shared value is still in its genesis. Attaining it will require managers to develop new skills and knowledge and governments to learn how to regulate in ways that enable shared value, rather than work against it.

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Features

THE HBR INTERVIEW

"What Is It That Only I Can Do?"

John Mackey, CEO of Whole Foods Interviewed by Justin Fox | page 118



In 1977 Mackey moved into a vegetarian co-op, became its food buyer, and went to work in a natural foods store, putting him on the path to founding Whole Foods. An iconic brand, Whole Foods dominates natural-foods retailing in the United States. Mackey talked to HBR about how top management functions at the company (decisions are made by consensus), his sustainable seafood initiative, and what he means by "conscious capitalism."

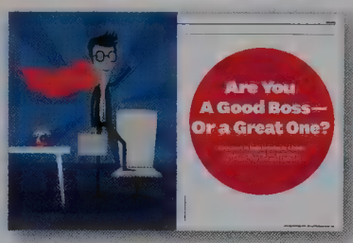
Among other things, conscious capitalism recognizes the stakeholder model, whereby customers, employees, investors, suppliers, larger communities, and the environment are all interdependent. Conscious leadership and a conscious company culture—which allows the organization to fulfill its higher purpose—are important ingredients as well. Part of Whole Foods' higher purpose is realized through the Whole Planet Foundation, which has set up microlending organizations in the communities where the company actually trades. "Nothing we've ever done in our history has created more goodwill with our team members than that," Mackey says.

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LEADERSHIP

Are You a Good Boss—Or a Great One?

Linda A. Hill and Kent Lineback | page 124



Many bosses have stopped making progress because they simply *don't know how to.*

Private moments of doubt and fear come even to managers who have spent years on the job. Any number of events can trigger them: an initiative going poorly, a lukewarm performance review, a daunting new assignment. HBS professor Hill and executive Lineback have long studied the question of how managers grow and advance. Their experience brings them to a simple but troubling observation: Most bosses reach a certain level of proficiency and stay there—short of what they could and should be. Why? Because they stop working on themselves.

The authors offer what they call the three imperatives for managers who seek to avoid this stagnation. First, *manage yourself*—who you are as a person, the beliefs and values that drive your actions, and especially how you connect with others all matter to the people you must influence. Second, *manage your network*. Effective managers know that they cannot avoid conflict and competition among organizational groups; they build and nurture ongoing relationships. Third, *manage your team*. Team members need to know what's required of them collectively and individually and what the team's values, norms, and standards are. The authors include a useful assessment tool to help readers get started.

HBR Reprint R1101K

STRATEGY & COMPETITION

How to Make the Most of Your Company's Strategy

Stephen Bungay | page 132



Corporate strategy often seems abstract to managers on the ground, who struggle to translate it into a realistic plan of action. But a process called strategy briefing, which originated with the military, can help them overcome that challenge. Bungay, the director of the Ashridge Strategic Management Centre, describes in this article how briefings can move managers and their reports from confusion about a complex set of goals and performance measures to clarity about just which objectives each person needs to focus on and in what order. Using a fictional case study as an illustration, Bungay outlines the five critical steps of the process:

1. State your intent, or what you are expected to do and why.
2. Revise it in the context of your company's situation.
3. Determine which measures indicate whether you're achieving your goal.
4. Define the tasks implied by your intent.
5. Define the boundaries, or constraints, that limit your team.

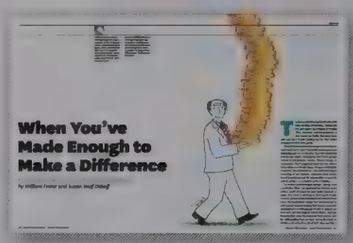
A single strategy briefing can help a team perform better, but the real magic happens when briefings roll down through an entire organization. When that occurs, the company's strategy is broken into a cascade of discrete but linked elements. In the end, people will be strategically aligned and operationally autonomous—a combination that is one of the hallmarks of high-performance organizations.

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NONPROFIT MANAGEMENT

When You've Made Enough To Make a Difference

William Foster and Susan Wolf Ditkoff | page 142



Many philanthropists have big ambitions, but even the richest individuals and largest foundations don't have enough money to end poverty, reverse climate change, or cure cancer. And many donors impose substantial costs on their grantees by, for instance, becoming excessively involved in program design or imposing burdensome reporting requirements.

To achieve breakthroughs, donors need a multiplier effect—an approach that delivers many dollars' worth of impact for each dollar invested. In short, they need an investment model.

To develop a sound model for philanthropy, donors must understand the methods of change that breakthrough results require. These include building robust nonprofit organizations, modifying public policy, establishing intermediaries, and facilitating research. The Draper Richards Foundation, for example, helps direct-service nonprofits build their capacity and capabilities; the James Irvine Foundation created an intermediary organization to improve high school education in California.

Donors must also understand how they can best support those efforts—through the roles they play, the resources they devote, and the relationships they develop. Michael J. Fox, for instance, has used his celebrity and credibility in his foundation's efforts to cure Parkinson's disease.

Developing a clear investment model doesn't have to be complicated or expensive, just deliberate. Without one, donors risk adding little value and imposing steep costs.

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How I Did It

LEADERSHIP

Maclaren's CEO on Learning from a Recall

Farzad Rastegar | page 41



When the chief executive of Maclaren USA learned about a rise in injuries to children's fingers involving the hinges on his strollers—which were similar to those used for almost all strollers on the market—he and his colleagues immediately began working with the U.S. Consumer Product Safety Commission to plan a voluntary "recall," during which the company would send protective hinge covers to anyone who wanted them. Maclaren saw this as an opportunity to educate parents about stroller safety as well as to protect children. But news of the recall was leaked early in a sensationalist report, and the company was unprepared to cope with the response. Thousands of concerned parents tried to reach Maclaren, causing its communications systems to crash: Callers got a busy signal; e-mails went into the ether; the website froze. The company's executives realized that they would need four times as many extra employees and three times as many hinge covers as they'd originally thought to manage the recall. Rastegar explains how and why their careful planning fell short, discusses the lessons he and Maclaren learned, and affirms his commitment to pursuing industrywide safety standards.

HBR Reprint R1101A

Managing Yourself

Stop Holding Yourself Back

Anne Morriss, Robin J. Ely, and Frances X. Frei | page



After working with hundreds of leaders in a wide variety of organizations and in countries all over the globe, the authors found one very clear pattern: When it comes to meeting their leadership potential, many people unintentionally get in their own way. Five barriers in particular tend to keep promising managers from becoming exceptional leaders: People overemphasize personal goals, protect their public image, turn their competitors into two-dimensional enemies, go it alone instead of soliciting support and advice, and wait for permission to lead.

Troy, a customer service manager, endangered his job and his company's reputation by focusing on protecting his position, not helping his team; when a trusted friend advised him to change his behavior, the results were striking. Anita's insistence on sticking to the tough persona she'd created for herself caused her to ignore the more intui-

reached out to
Jon, a personal
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Only then will the
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HBR

THE GLOBE

STRATEGIC INVESTMENT

Investing in the Post-Recession World

Sage Newman, Courtney Rickert, and Ross D. Schaap | page 150



Now that the global recession is officially over, multinationals are starting to weigh their options for foreign investment. But everywhere they look, negatives vie with positives, and government actions and contradictory economic trends confuse the picture: Brazil is planning to spend while Australia is cutting back. Trade tensions are rising between the United States and China. Indonesia tempts inflation by keeping rates low.

Managers need a way to cut through the chaos and figure out which countries are the best bets and which pose the greatest risks. The authors, drawing on Eurasia Group's political analyses and on economic databases, have assigned scores to a selection of countries on the basis of their macroeconomic conditions and foreign investment environments. The result is a practical guide for determining where growth is likely, which governments are encouraging or impeding foreign investment, and which sectors provide the greatest opportunities. Some of the results are surprising.

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Life's Work

HBR.ORG To read the extended interview, go to **hbr.org/marsalis.**



Wynton Marsalis grew up in a family of New Orleans jazz musicians and received his first trumpet as a sixth birthday present from bandleader Al Hirt. At 14 he debuted with the Louisiana Philharmonic; at 17 he moved to New York, where he attended Juilliard, joined Art Blakey's Jazz Messengers, assembled his own band, and began a prolific composing and recording career. In 1987, Marsalis founded Jazz at Lincoln Center. *Interviewed by Katherine Bell*

HBR: **How did you learn to lead?**

Marsalis: I was always a leader on teams. I called the plays in football, pitched baseball, played point guard in basketball. The guys would always ask me, "Man, what do you think we ought to do?"

When I was young I was too harsh on the musicians. The people who played with me taught me how to be better. I learned to have a clear direction. If you are wishy-washy or you lack heart, they can't follow you. It's exactly like leading on a horn. I play fourth trumpet, following Ryan Kisor. He's young, but a great lead player. He lets you know what he's going to play before he plays it. If everything's falling apart, he comes in. You can depend on him.

How is leading a band like running a company?

You have to know what your people can do. The ones who need to be challenged, you give them challenges. The ones who need to be carried, you carry them. The ones you need to let go, you let them go. A leader has got to have a certain kindness but a certain meanness, too.

What's your theory on talent versus practice?

You can become proficient at anything. If you're a boxer, you can practice four million hours and become proficient to a certain point, but if you don't have the talent, you won't be the one to beat. You can't practice the ability to make connections or have a deep, spiritual insight. To be great, you need courage to speak out and endurance to deal with what is given to you. Ornette Coleman got beat up for playing his music, but he played it. That's not something you can practice your way into.

How do you hire musicians?

I look for four things: First, individuality. Do they have a unique sound? Second, knowledge of the music. Third, do they respond well to pressure? And fourth, do they want to be a part of us?

Do you need to be alone to compose?

I grew up in a big family with a lot of noise. I like distraction. As a matter of fact, if I'm composing, I'll turn the television on. It makes me concentrate more deeply on what I'm doing.

You've been criticized a lot for taking a conservative approach to jazz.

I like being critiqued. I always knew I was original. If anything, the criticism made me more determined to go in my own direction. You have to assess criticism and then make your own decisions. You have to say, "We're going this way." That's what steels your leadership—you survive and become a better leader. If you can't take it, you're not the leader.

What can leaders learn from listening to jazz?

If you hone your listening skills so that you can follow the development of a solo, you can listen more empathetically to people when they talk and hear underneath what they're saying. You can feel their intention.

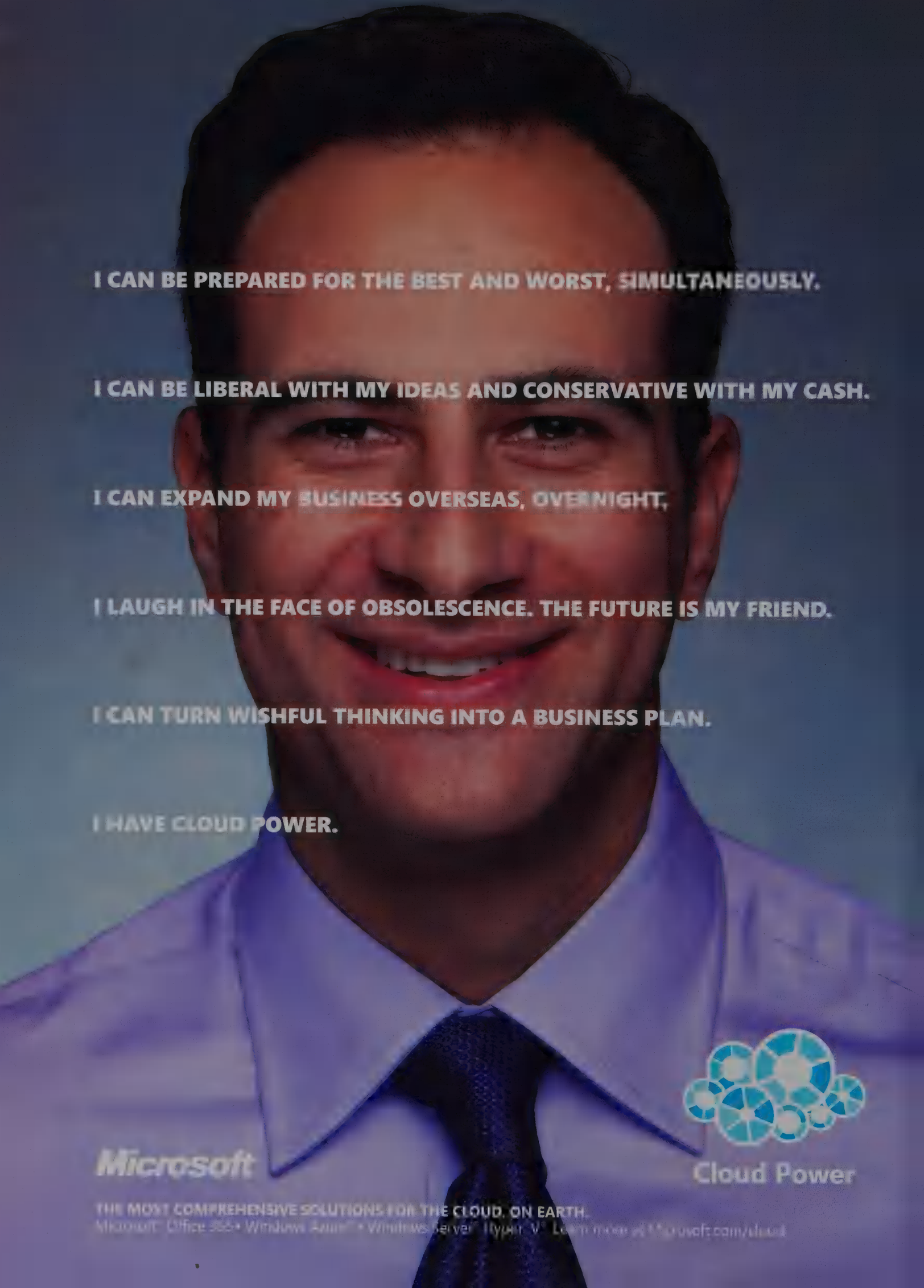
What has composing taught you about creativity?

Celebrate your traditions as you innovate. As you come up with new things, always reach back. Offer everything you have all the time.

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Breguet, the innovator.

Invention of the shock-protection device, 1790

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THE BEST PART OF GIVING SOCCER BALLS TO KIDS IN AFRICA IS SEEING THE LOOK ON THEIR FACES.

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Tommy Clark uses soccer to teach kids in Africa about AIDS. Sounds crazy, but it works. His organization's success relies on his supportive partners. So when the kids' makeshift balls proved a problem, he found philanthropist Bobby Sager, who donated 10,000 indestructible Hope Balls after meeting face-to-face.

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About the Spotlight Artist
Leandro Erlich was born in Buenos Aires in 1973. At age 20, he won a grant from the Antorchas Foundation to take an advanced sculpture and installation workshop under the direction of Luis F. Benedit and Pablo Suárez. He went on to present solo exhibitions in New York and Europe and to display installations in museums and private collections. Erlich lives and works in Paris and Buenos Aires.

Erlich's work respects reality while asking viewers to thoughtfully reconsider it. In one installation, a life-size photo of a building becomes a façade when backlit, and a giant mirror at a 45-degree angle gives the impression that the participants posing beneath are falling from its windows. We are helpless observers at first, but in seconds it becomes obvious that the effect is an illusion.



ABOVE
Leandro Erlich
***La Torre*, 2007**
metal structure, wood, mirror, glass
11.5 x 29.5 x 9.84 feet
Installation at Museo Nacional Centro de Arte Reina Sofia, Madrid

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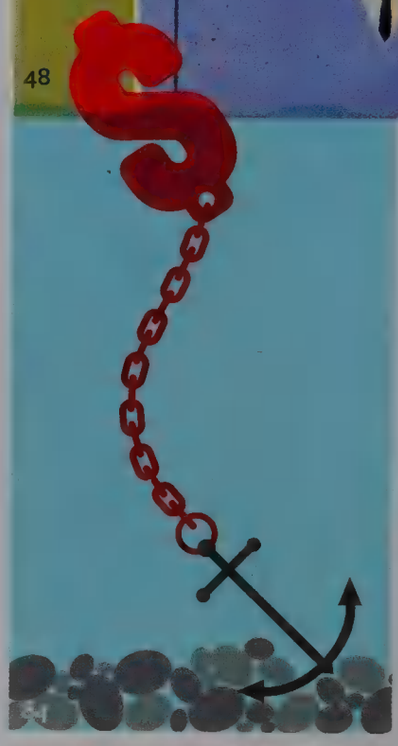
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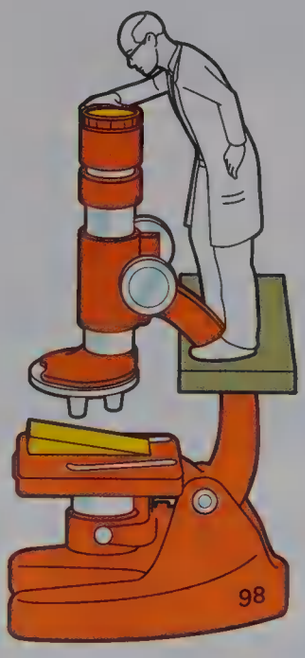




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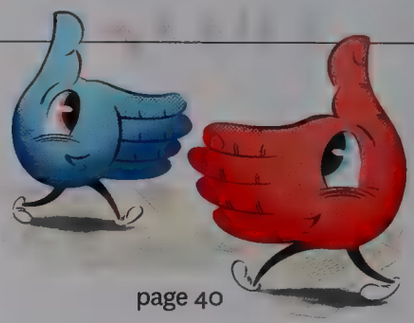
WE AGREE.

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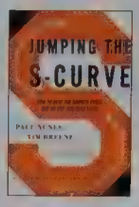


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From the Editor

Move Up and Step Up

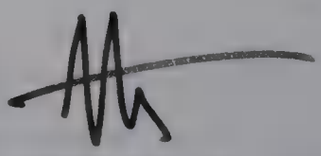
At HBR we divide our mission into two parts. The first is to present the latest management thinking to help our readers guide their companies and careers. This month's cover story, "The New Path to the C-Suite," does just that. It was written by Boris Groysberg of Harvard Business School and two executives at Heidrick & Struggles: L. Kevin Kelly, the CEO, and Bryan MacDonald, a partner. Combining Groysberg's analytical expertise with the executive search firm's impressive collection of data has produced a must-read for anyone who hopes to understand what skills companies are looking for today as they develop top talent. The authors describe the new paths leading to seven C-level jobs, and their findings are both practical and intriguing. For example, the talents now in vogue include strong communication, empathy, collaboration, and trust building. (Will the number of female CEOs increase?)

Groysberg, who is one of our most prolific authors in recent years, is someone to listen to. A recent *Wall Street Journal* article noted that Paul DePodesta, the New York Mets' new vice president of player development and scouting, is a devotee of Groysberg's book *Chasing Stars,* which outlines how organizations can foster environments where talent will thrive. The article suggested that it could be the new *Moneyball:* the latest application of business thinking in the world of sports.

The second part of our mission is to present important new thinking on the economy. The Great Recession has prompted many top minds in our field to offer ideas for fixing an economic system that let us down. In "Capitalism for the Long Term," Dominic Barton, the global managing director of McKinsey & Company, essentially warns that unless business leaders fix the flaws in the system, they'll be watching from the sidelines as governments do it for them. If Barton, who has spent 24 years with McKinsey, is now sounding the alarm, surely it's finally time for executives and policy makers everywhere to tackle the perennial problems that are somehow never adequately addressed: excessive short-term thinking, misguided CEO pay, ineffective boards.

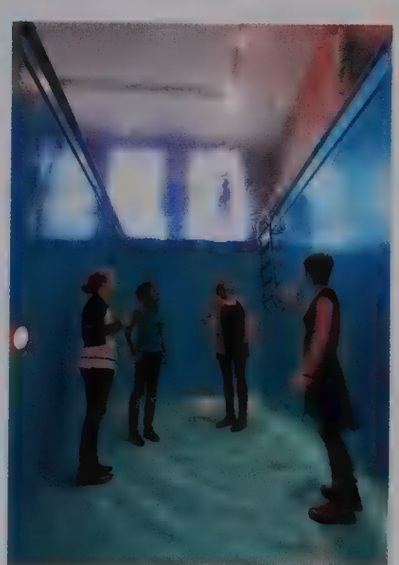
Lastly, in "The New M&A Playbook," Clayton Christensen and Richard Alton of Harvard Business School, Harvard Square Partners' Curtis Rising, and Innosight's Andrew Waldeck explain when to go for a "killer deal" and when it's probably not worth the effort.

I hope you'll feel we've achieved our mission this month.

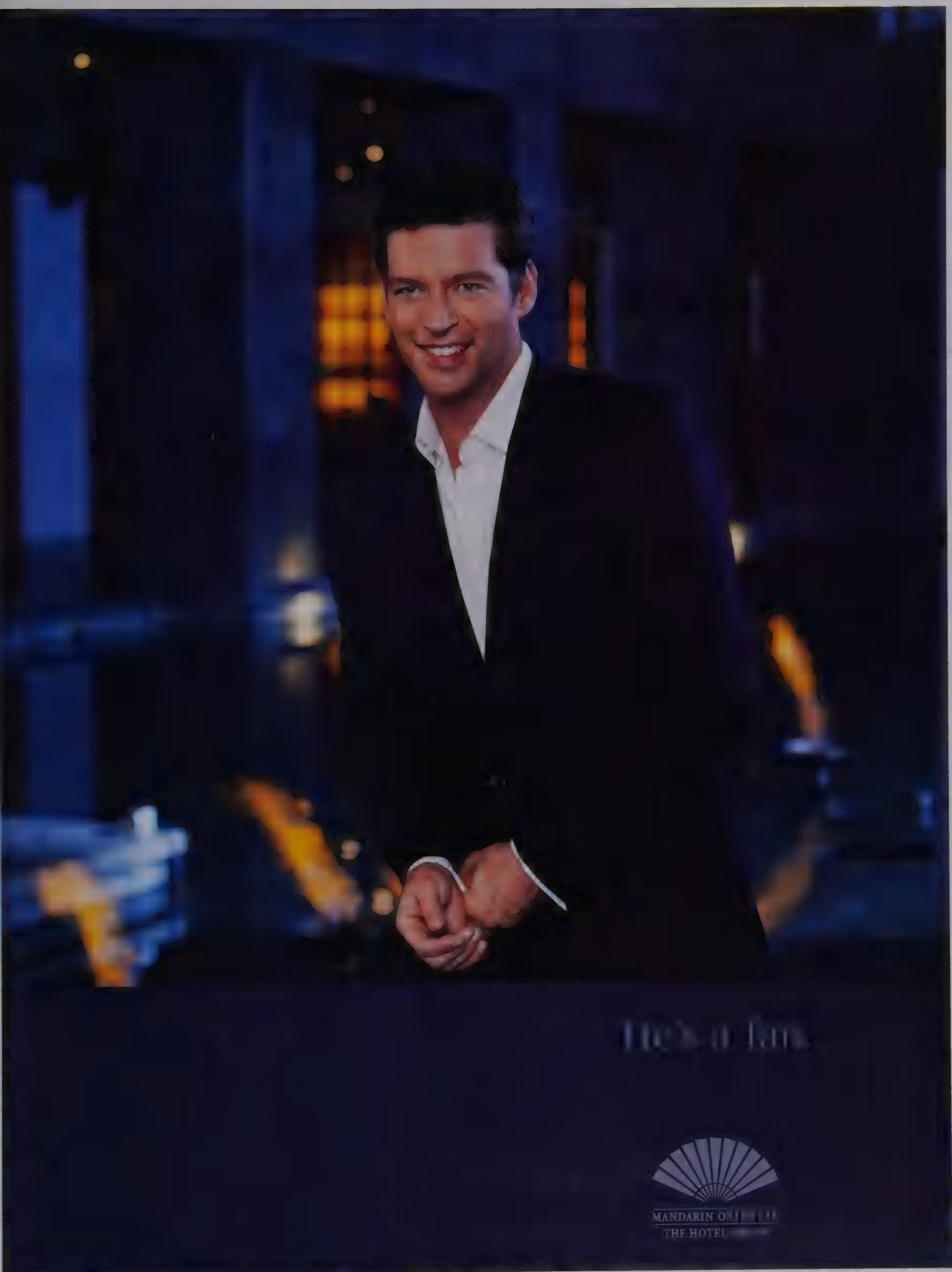


Adi Ignatius, Editor in Chief

This month's Spotlight artist, Leandro Erlich, confounds viewers with disorienting installations that defy the laws of physics.



ABOVE
Swimming Pool, 2008
mixed media
Installation at MoMA PS1,
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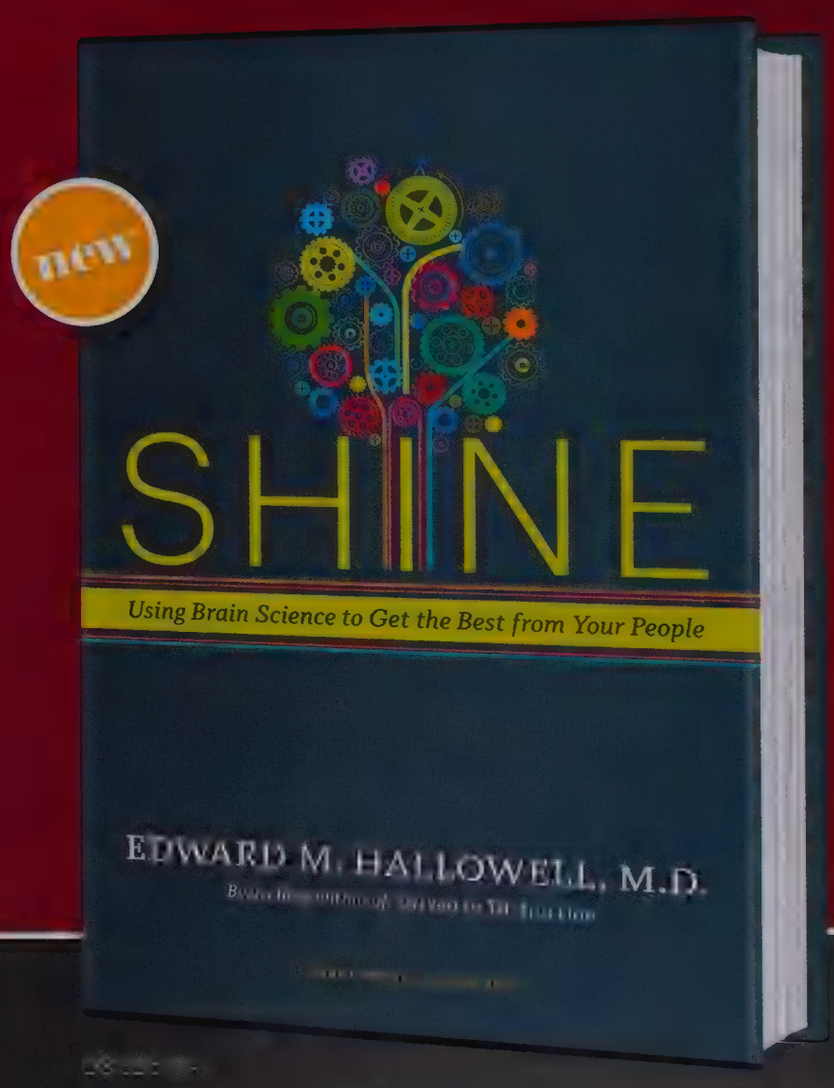
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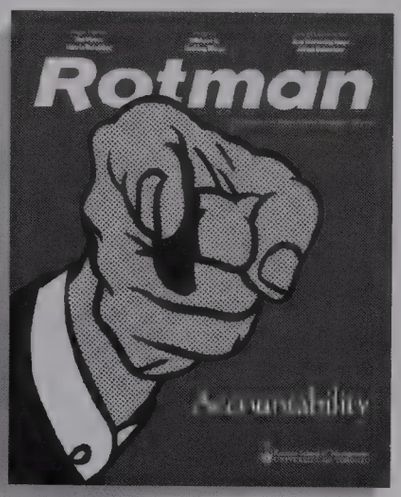
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What's the Hard Return On Employee Wellness Programs?



HBR article by **Leonard L. Berry, Ann M. Mirabito,** and **William B. Baun,** December 2010

How much does employee health affect the bottom line? Significantly, say Berry, Mirabito, and Baun, who provide hard ROI data to support the notion that promoting workforce wellness can benefit your business. For example, their research found that wellness programs at Johnson & Johnson, which included a mandate that all facilities be tobacco free, "cumulatively saved the company $250 million on health care costs over the past decade."

If promoting employee wellness is what corporations ought to do, then what is the role of the health care system at large? Employee wellness systems are like any other service. Employees should pay for a percentage of these services or be encouraged to participate in such programs on their own. Otherwise, we are leaning dangerously toward what history has shown us is not a sustainable practice. Large, state-controlled corporations in the Eastern bloc (before the collapse of communism) provided medical services to their employees. These organizations were absolutely unable to compete in global markets.
Michael Paduch, president and founder, Sophic Technologies

The point is that you aren't paying for it. The wellness program provides a return to the company and is a benefit rather than a cost.
Qianyilong

Wellness programs generate intangible benefits. The employee becomes more loyal to the organization because it is taking care of him and his family.
Raghunandan G, senior project manager, Robert Bosch Engineering and Business Solutions

Successful wellness programs affect employees' behavior (encouraging workers to complete health-risk appraisals or participate in walking competitions, for example) by reducing barriers to change. The challenges include influencing perceptions about the need to be well and addressing potential roadblocks in the environment that prevent employees from sticking with healthful behaviors over the long run.
Jeremy Citro, director, Executive Advisory Services, Corporate Leadership Council

Smaller companies, start-ups especially, need to pay attention to wellness. Their employees work longer hours, eat garbage, juggle a lot of responsibilities, and deal with a lot of stress; and losing an employee in a smaller company has a big effect.
Gary Cornelisse, owner and software engineer, Summit Media Concepts

The authors respond: *The smaller firms in our study are passionate advocates of investing in a healthier workforce. More-*

How to Bring Out The Best in Your Boss

HBR blog post by **Liz Wiseman,** December 2010

According to leadership researcher Wiseman, there are two types of managers: "'diminishers,' who get less than 50% of the capability of people around them, and 'multipliers,' who get virtually 100%." You can't change your boss from one to the other, but you can "multiply up" and improve your relationship. The key is to exploit your boss's strengths and to listen and learn.

An important character trait of any leader is the ability to work effectively with others with whom you might not immediately "click." You cannot always choose your business partners, your team leaders, or your staff, but you can find ways to create value for them (and with them) by being flexible in your management approach. Focusing your energy on what you can control, rather than what you cannot control (for example, another person's perspective or behavior), is the solution to dealing with a diminisher. Changing how you act and respond to a "diminisher" boss reframes a problem into a solution. If you can cultivate the mul-

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over, small businesses employ half of the private sector workforce, so their investment in workplace wellness is critical to improved population health.

Imagine if a university had a robust wellness program for students and allowed access to some or all of it to alumni. That would produce healthier graduates who would be more appealing to employers and more inclined to support the university after graduation.
Jim Gallagher, senior vice president, Sales and Client Relations, USI Affinity

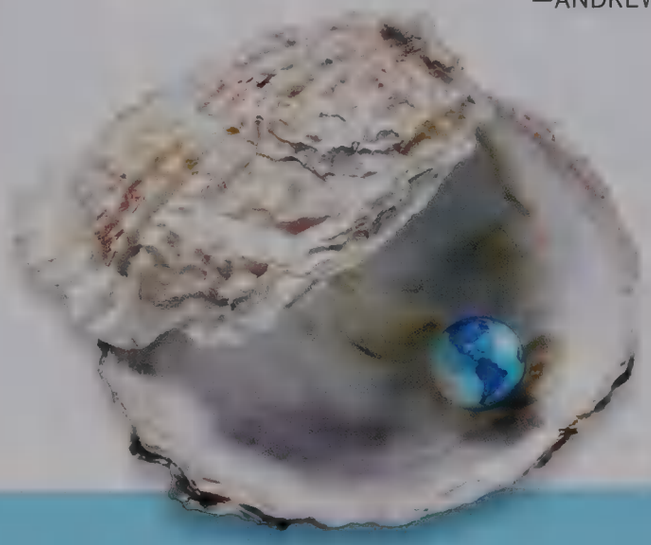
The authors respond: *Why stop there? Universities can create "cultures of health" that reach not only students and alumni but also faculty and others in the community. The University of Wisconsin offers a healthy-living course, a health-risk and fitness assessment, and coaching. Rice University in Houston allows alumni to use its popular wellness center. The University of Arizona sponsors community programs, including a 10-week series for inactive older people. Giving students lifelong wellness habits and being a community wellness leader may certainly encourage the kind of reciprocal support for a university that Gallagher suggests.*

tiplier in yourself, then you won't ever have to worry about the diminishers in your world.
Sylvia P.

When you have to deal with narcissistic types who were promoted into their positions but lack business knowledge, you'll see that "diminishing" equals "destroying." They are hiding incompetence.
Tom Bender, change management consultant, AGREDEA

"The first one gets the oyster, the second one gets the shell."

—ANDREW CARNEGIE



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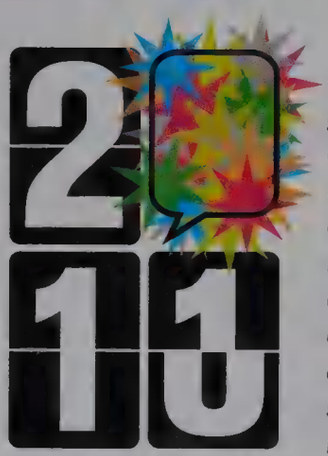
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Six Social Media Trends for 2011

HBR blog post by **David Armano,** December 2010

In answer to that ubiquitous question "What will social media become?" Armano, senior vice president at Edelman Digital, forecasts further integration, tablet wars, social media schizophrenia, the return of the company website, and the innovative moves by Facebook and Google. Then our readers weighed in with their own ideas of what's in store for the amorphous world of Web 2.0.



Right now, companies share general information, regardless of different users' needs. Companies will adapt, personalizing tweets or posts to specific users according their preferences.
Cláudio Trovisco, CEO, Trovidoce

Monetization will become the largest social trend. Ghosts of the dot-com era are coming back to haunt CMOs as eyeballs (otherwise known as likes and followers) remain the sole metric used to evaluate success. Our challenge is to credibly measure and advance social marketing's impact on real outcomes and stop repeating the sins of the past.
Jeff Bodzewski, director of social marketing, Aspen Marketing Services

This year we'll reject false influence metrics like Twitter followers and find hidden influencers.
Ian Greenleigh, Social media manager, Bazaarvoice

The author responds: *As we begin to understand context more (putting more emphasis on relevance), we can expect progress in these areas: influence identification (who in a network has influence and how potent it is); influence behavior measurement (what can be tracked as a direct link from the people who influenced the behavior); and influence predictive modeling (using data to predict what is likely to influence the people you want to reach). Right now most tools simply show the size of someone's social graph, and popularity can be gamed (faking the number of Twitter followers you have is a perfect example of this). Influence is about regularly engaging people on topics and influencing action. Oprah, for example, does this with women. In social media, thousands of mini-Oprahs influence their peers, friends, and family to act. So we need a better understanding (and better tools) to measure influence in the digital space.*

Social media will be a driver of employment as businesses outsource social media. The challenge will be ensuring that messages are within the borders of the brand.
Waztech

In 2011 people will begin to realize there are few shortcuts with these sites—it's "social" media, not "robot" media.
Resercom

The author responds: *You can automate only so much. The key is creating advocates in customers, employees, and partners.*

Look out for new start-ups—think Facebook for strangers with a lot in common—that will take networking to a global level.
Anne A. Balduzzi, founding partner, Accelerate Partners

The author responds: *Sounds like what the blogosphere used to be—a global village.*

Lessons from WikiLeaks

HBR blogs, November–December 2010

Julian Assange's endeavor to disclose classified documents has altered the way many of us think about privacy, technology, transparency, and diplomacy—and a lot more. But how is this monumental shift going to affect management thinking?

"How WikiLeaks Changes Things for Us All," by Carne Ross *"Thanks to WikiLeaks, you can now expect that day to come when your most private and candid communications will appear for all to peruse. In preparation for that moment, you better make sure that your private dealings match your public declarations."*

It is even more daunting to think that we will be judged on what we choose *not* to say. Our espoused values must be matched by both the statements we commit and the ones we omit. In some ways, being held accountable for the sins of omission will be the bigger issue in a corporate environment.
Julia Kirby, editor at large, *Harvard Business Review*

"Why WikiLeaks Matters More (and Less) Than You Think," by Umair Haque *"The real scandal might just be this: There are few secrets bigger and more terrible than the ones that are hiding in plain sight. The ones we ignore, sweep under the rug, and won't, don't, or can't discuss....Here's the big economic secret that we already know: 20th century institutions aren't fit for 21st century prosperity."*

As with anything else, we unlock value by exercising discretion in pursuit of the greater good.
Bill Free, principal, William Free Communications

The bitter pessimist in me sees the old guard as overpaid managers incapable

ILLUSTRATION: MATT DORFMAN

of leadership, clinging desperately to whatever power they hold over the masses through information hoarding. The hopeful optimist in me sees smaller organizations innovating and doing a better job of serving the public (and the greater good).
Brian Driggs, founder, Gearbox Magazine

"Could WikiLeaks Expose Your Corporate Brain?" by David Gordon and Sean West *"Forget about worrying that some executive's flip e-mail message will fall into the wrong hands. Now there's a real risk that the entire corporate brain could be exposed, just as the diplomatic brain of the U.S. government has been opened for all to explore."*

WikiLeaks is "risky" only if your business is dishonest.
Anonymous

"Did WikiLeaks' 'Cablegate' Result from Too Much Information Sharing?" by Andrew McAfee *"The fact that [Private Bradley Manning] had access to cable traffic isn't evidence of a problem; it's evidence that access to digital information within the [intelligence community] is better than it used to be....[T]echnology is not the culprit here; a misguided person is."*

The last thing I would want to see as a former intelligence officer is more controls on the flow and use of classified information. This was a human failure, which is the hardest to detect and solve.
Carl Rogers

With web 2.0 technology, we need to learn what should or should not be shared. Officials should have been more selective, even if the information they shared was labeled "sensitive."
Bill Skerpan, associate, Arc Aspicio

It's always a management issue. Real people have to manage other real people.
James Ryan, change facilitator, Lotus Development

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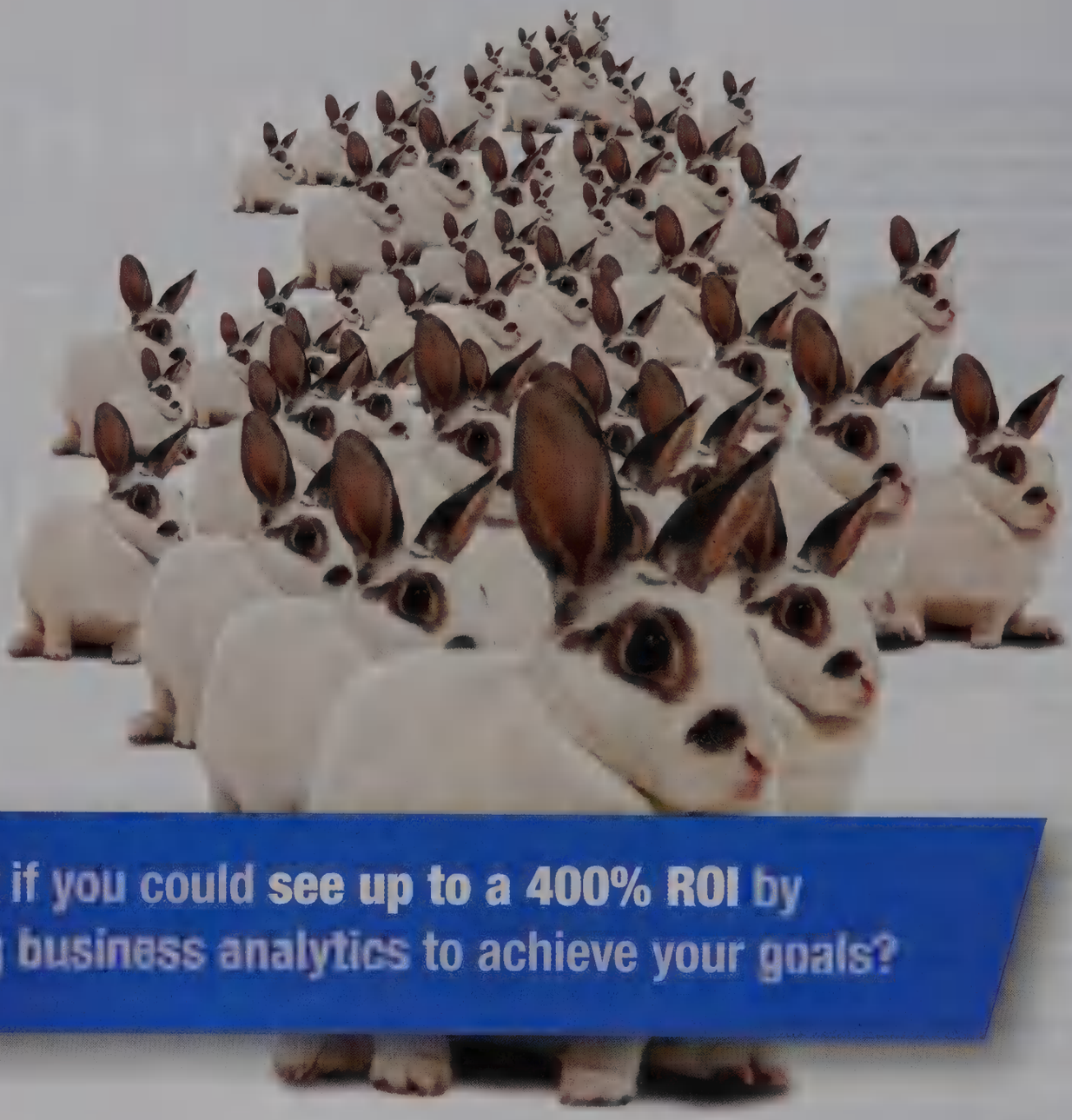
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Idea Watch

New Thinking, Research in Progress hbr.org

FIRST

The Battle for China's Talent



Western multinationals are losing their luster as employers of choice. Here's how they can regain their advantage. *by Conrad Schmidt*

For more than 15 years, one major U.S.-based multinational we've worked with (which asked to remain anonymous) had no trouble hiring top graduates of China's most prestigious universities. Its recruiting sessions, held in campus auditoriums, were typically standing room only. After the formal presentations, students would rush the stage with questions. But that's changed in the past year, as a company VP described during a recent meeting of senior HR executives in Shanghai. Student interest in foreign multinationals has fallen dramatically. These days the auditoriums are only about a quarter full, and just a few students approach the recruiters. The other HR chiefs at the meeting were sympathetic: Many of them are experiencing the same thing.

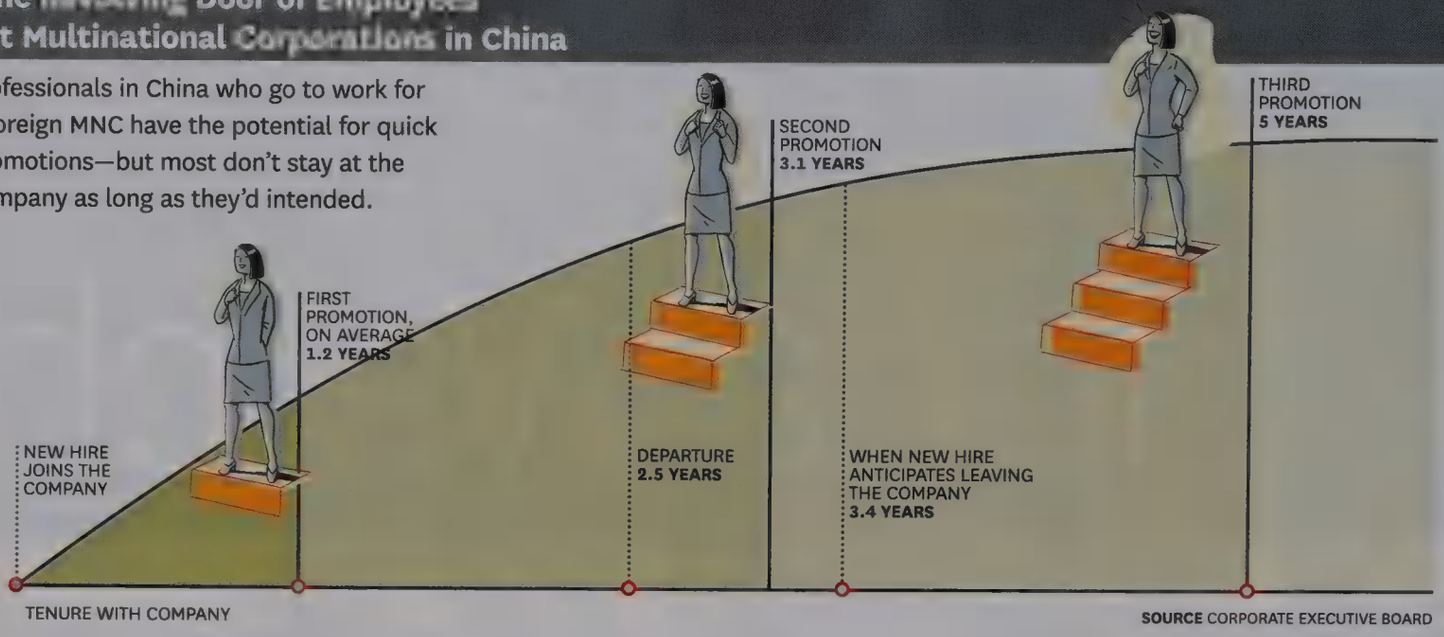
Attracting talent in emerging markets has always been a challenge for Western multinationals, but historically they've enjoyed a big advantage: Local workers have viewed them as employers of choice, offering higher status and better career prospects than domestic companies. Now that attitude is shifting, and a growing proportion of high-potential Chinese workers see domestic employers as a better bet.

The Corporate Executive Board has been collecting data on employees and job candidates in China since late 2006. We've surveyed more than 300,000 of them and worked with HR teams at more than 60 companies, and our data quantify this shift. In 2007, 41% of high-skill Chinese professionals preferred working for a Western multinational, while 9% preferred a job with a domestic firm—a comfortable 32-point gap. By the second quarter of 2010, the preference for MNC employment had risen to 44%, but the preference for Chinese employers had jumped to 28%—shrinking the gap to 16 points. (Sectors losing share to private Chinese employers include government, state-owned enterprises, self-employment, and education.) In just over two years, Western companies' hiring advantage was cut in half. Anecdotal reports, like the one from the VP in Shanghai, suggest that the gap may be narrowing even faster.

This shift is driven in large part by the fact that Western firms and their brands took a significant hit in the Great Recession, while the Chinese economy—and local career opportunities—continued to grow. Although the popular press refers to the "global" economic slowdown, China has largely escaped the effects: Its GDP rose more than 9% annually in 2008 and 2009. During that time Western companies reduced hiring, cut expenses, and in some cases resorted to layoffs. So Chinese workers are reacting rationally, figuring that career opportunities will be constrained

The Revolving Door of Employees At Multinational Corporations in China

Professionals in China who go to work for a foreign MNC have the potential for quick promotions—but most don't stay at the company as long as they'd intended.



SOURCE CORPORATE EXECUTIVE BOARD

in Western companies undergoing restructuring and diminished growth.

But there are other factors in play. According to Western HR executives who work in China, opportunities for global training and experience outside China—perks that once helped make MNCs preferred employers—are becoming less attractive to Chinese professionals. These workers now see that the best immediate and long-term career development opportunities are likely to be found in one of the world's fastest-growing economies—that is, right at home. Many also express a desire to remain in their own cities, as growing incomes allow a higher quality of life in China's increasingly cosmopolitan centers.

In addition, many local workers believe they will hit a glass ceiling at MNCs because of a preference for expatriate management. Although the number of foreigners in senior positions varies widely by company, fully 40% of the Chinese MNC employees we surveyed thought that most senior positions are, and will continue to be, held by expatriates. National pride is also a factor: Western recruiters tell of faculty members at Chinese universities who talk up the patriotic appeal of working for domestic companies, and those companies' recruiters pull at the same emotional strings.

Some Western companies trying to retain local talent feel they're under attack. One major U.S.-based industrial goods producer we work with has seen domestic firms aggressively recruit its experienced Chinese middle managers and junior executives. Local companies offer these professionals "skip-level" promotions that put them straight into jobs with senior titles and greatly expanded responsibilities. An executive at a European consumer goods company told us she believes that some of her key Chinese employees get recruiting calls every day. A partner in the Beijing office of one executive recruiting firm confirmed the phenomenon, saying that his company targets Chinese executives in their late 30s and early 40s who may be disillusioned with their progress at Western MNCs. His firm not only is finding more takers when it reaches out to candidates, he told us; it's also getting more "inbound" requests from employees of Western MNCs—a clear sign of growing discontent.

How Can Western Companies Fight Back?

Here are five strategies companies should consider, extrapolated from our survey data and our work with Western MNCs operating in China.

Reboot employment branding efforts. Even though multinationals' lead over domestic employers is shrinking, it hasn't disappeared: More Chinese professionals still want to work at Western than at domestic companies. And our surveys show that employees of multinationals are much more satisfied with their work and their career prospects. MNCs need to regain their advantage in the labor market by more effectively communicating their overall stability, their commitment to China, and their focus on individual employee development.

Western companies trying to retain local talent feel under attack. One European executive says her key Chinese workers get recruiting calls every day.

Consider Cisco Systems (which, like many of the companies named in this piece, is a client). It takes a strategic approach to building a strong employment brand in China, putting out broad messages about its employment value proposition and targeting key technical talent. It also publicizes its government partnerships, high-profile university alliances, and business school sponsorships—all of which increase its visibility in the labor market. Cisco has used this "broad and deep" approach to great effect, generating the biggest improvements in company awareness and underlying employment brand strength that we've seen in our surveys of the Chinese labor market.

Create local development opportunities. Until recently, the typical high-potential Chinese professional who signed on with a Western company hoped to be posted at some point to the firm's headquarters. MNCs need to recognize that today more job candidates want to stay in China while advancing their careers and need to create roles that will accommodate this desire. Shell, for example, modified

its approach by complementing long-term global assignments with short-term ones for its Chinese staff. These shorter rotations are focused on closing specific developmental gaps and quickly returning staff to China. In addition, Shell has increased its job rotations into China, exposing more global leaders to the Chinese market.

Offer viable career paths. High-potential talent in China is attracted to—and stays with—companies that offer compelling long-term career paths. But Western firms often struggle to meet the aggressive advancement expectations of Chinese employees. Western MNCs, partly as a strategy to create global leaders, have a history of rotating high-potential Western employees into senior posts in emerging markets—creating the glass ceiling that Chinese professionals worry about. They need to recognize the advantages of establishing and highlighting long-term career paths for Chinese employees as well. Dow Chemical, which has traditionally used career development to attract and retain top Chinese talent, consistently ranks as one of the most popular Western MNCs among graduating Chinese university students. Its campus recruiting pitch is built on its commitment to diverse career paths. "Career ambassadors"—tenured, successful midlevel managers and executives—give candidates a firsthand account of how their careers were developed and managed at Dow. And once employees are on board, companies should ensure that career-planning conversations take place early on, in a deliberate, structured way.

Be smart about pay. According to some reports, domestic firms looking to raid Western companies of experienced technical talent and executives are offering dramatic pay increases—often as much as 50%. Retention challenges may force multinationals to consider pay increases as well, but they don't necessarily need to match what their Chinese rivals are offering. One large U.S.-based technology company has quietly implemented a policy under which local professionals who try to resign in order to join a domestic firm are automatically offered a 20% pay hike. It has found that many employees accept that counteroffer—suggesting that although competitive pay matters, other attributes are important, too.

Become a quasi-local company. Some HR executives point to Walmart as a Western company that's become so well established in China that it has many of the advantages of local employers. Indeed, in our employment brand surveys, Chinese professionals ranked Walmart as comparable to local companies in terms of attractiveness as an employer. Walmart's business model compels it to create a deep mutual dependence with local suppliers, and as a result it has more touch points with locals than MNCs typically do. The company is now a presence in a number of second- and third-tier Chinese cities, whereas many multinationals have branches only in Beijing and Shanghai. Having combined a global brand with stronger local roots, Walmart is well positioned to acquire the domestic talent it needs to keep growing in China.

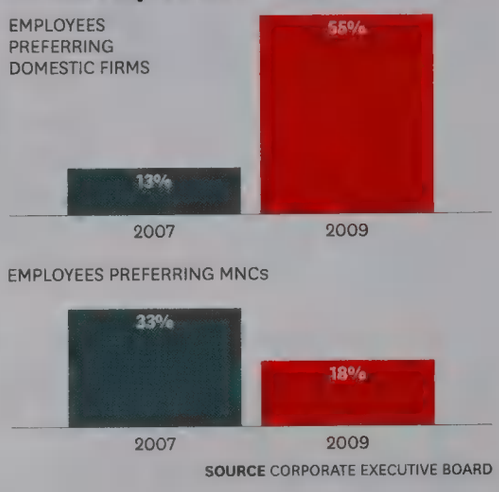
To be sure, over the long term the China talent challenge may be less troubling than it appears. Because much of the shift in sentiment about employers can be attributed to the global economic slowdown, it could turn out to be temporary. And either way, there may be a small but meaningful silver lining: A rising number of young high-potential Western employees now view China as *the* place in which to develop their careers. This new generation of would-be expats could help fill key gaps in middle management and senior leadership if Chinese professionals' migration to domestic employers continues. But for now, Western recruiters will have to get used to looking over a smaller number of prospects when they visit Chinese universities—and be prepared to fight harder to win them.

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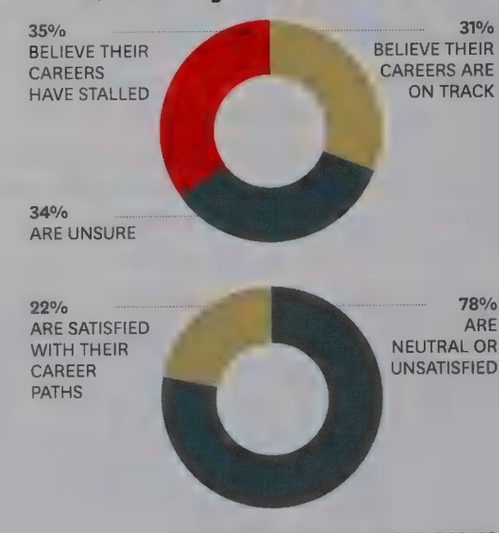
Conrad Schmidt (schmidtc@executiveboard.com) is an executive director and the chief research officer of the Corporate Executive Board's Corporate Leadership Council. He is based in Washington, DC.

Fewer Chinese Working at Local Firms Aspire to Work for MNCs



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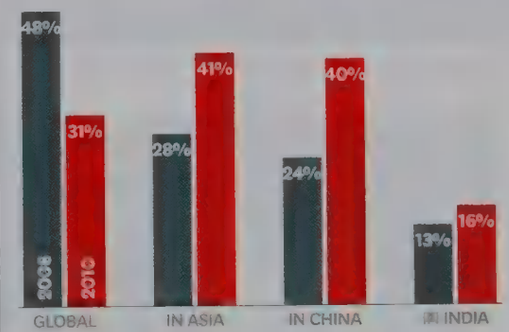
Among Chinese Working at MNCs, Anxiety About the Future



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Talent Is Getting Scarce in Asia

Companies having trouble filling jobs (percent):



SOURCE MANPOWER GLOBAL TALENT SHORTAGE SURVEY, 2010

Stat Watch

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45%

MORE CITATIONS are garnered by research papers whose authors (four or fewer) are in the same building than by papers whose authors are in separate buildings, even on the same campus. According to Harvard Medical School's **Isaac Kohane**, who led the study that produced this result, "Physical proximity still matters for research productivity and impact"—a finding that presumably applies not just to academia but to business as well.

TECHNOLOGY *by James B. Oldroyd, Kristina McElheran, and David Elkington*

The Short Life of Online Sales Leads

Are you confident that your company is effectively handling potential customers' online queries? Think hard. Our research shows that most companies are not responding nearly fast enough.

Companies in financial services, automobiles, education, software, health care, professional services, and many other industries have increasingly turned to the internet to generate sales leads. Indeed, corporate spending on online advertising aimed at drumming up leads to potential customers soared from $12.5 billion in 2005 to $22.7 billion in 2009, and it's still growing strongly. Online brokerages that offer customers a simple way to get quotes from multiple companies and then sell the resulting leads to those companies are thriving in both the B2B and B2C markets. The business of providing technology and services to help companies turn online leads into sales is on the rise as well.

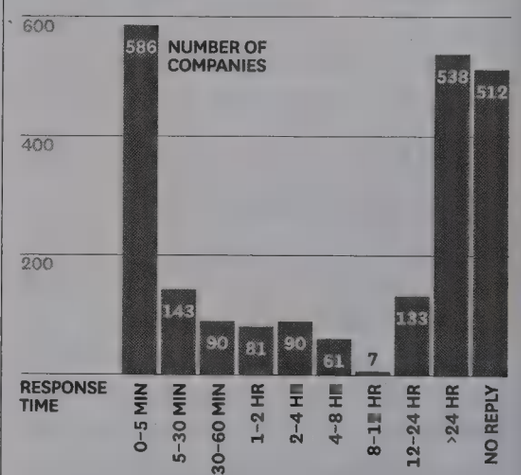
Nonetheless, our research indicates that many firms are too slow to follow up on these leads. We audited 2,241 U.S. companies, measuring how long each took to respond to a web-generated test lead. Although 37% responded to their lead within an hour, and 16% responded within one to 24 hours, 24% took more than 24 hours—and 23% of the companies never responded at all. The average response time, among companies that responded within 30 days, was 42 hours.

These results are especially shocking given how quickly online leads go cold—a phenomenon we explored in a separate study, which involved 1.25 million sales leads received by 29 B2C and 13 B2B companies in the U.S. Firms that tried to contact potential customers within an hour of receiving a query were nearly seven times as likely to qualify the lead (which we defined as having a meaningful conversation with a key decision maker) as those that tried to contact the customer even an hour later—and more than 60 times as likely as companies that waited 24 hours or longer.

Companies are making big investments in order to obtain customer queries from the internet, and they should be responding at internet speed. Why aren't they? Reasons include the practice of retrieving leads from CRM systems' databases daily rather than continuously; sales forces focused on generating their own leads rather than reacting quickly to customer-driven signs of interest; and rules for distributing sales leads among agents and partners based on geography and "fairness." We're conducting further research to more fully understand the causes and identify possible solutions. But it's already evident that most sales organizations need new tools and processes to meet the demands of the online age.

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Many Firms Are Slow to Respond



Top Lead Generators

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InsureMe.com
NetQuote.com
Insure.com
USInsuranceOnline.com
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Autobytel.com
AutoUSA.com
CarsDirect.com
iMotors.com

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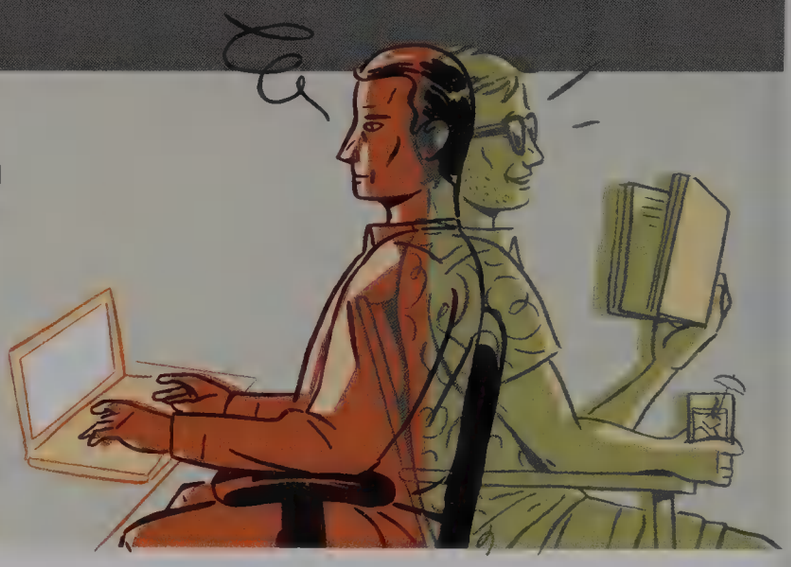
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Research Watch

Vacation? What Vacation?

In a study of 96 Dutch workers, **Jessica de Bloom**, of the Netherlands' Radboud University Nijmegen, and five colleagues examined self-reported levels of health, mood, tension, energy, satisfaction, and other indicators of well-being during several time periods: two weeks before a winter sports vacation; during the time off; and one week, two weeks, and four weeks afterward. They found that although the workers generally felt better while they were away, the restorative effects faded within a week of their return to the office. The group has proposed research to investigate what type—and length—of vacation yields the longest-lasting benefits and to identify strategies for prolonging post-getaway relief.



OPERATIONS *by Aditya Pande*

How to Make Onshoring Work

In recent years IT professionals have embraced a new strategy to cut costs: In addition to offshoring service work to ultra-low-wage countries such as India and the Philippines, they're onshoring it to low-cost American or European cities. Onshoring has become so popular, in fact, that some hope it will generate significant job growth in the developed world.

But making it work is no cinch. Companies must be extremely careful when choosing sites and developing employees if their onshore service centers are to be viable over the long term, research suggests.

To be sure, plenty of companies still look overseas for low-cost IT. But many governments require onshore handling of certain financial, health, and defense data, which represent more than 15% of all IT service work. In addition, companies often face challenges finding foreign technicians who can run legacy systems in industries including banking and insurance.

Areas such as northern France; eastern Germany; and the Great Plains, Appalachian, and southern regions of the United States contain pools of highly skilled workers who are less expensive than those in big Western metropolitan areas, our research shows. And governments are offering incentives for companies to set up operations there. For example, one global company opened a midwestern U.S. facility with more than 1,000 IT service employees. Wages at the facility are 35% lower than at headquarters, and the company received $50 million in government incentives.

Officials in job-starved regions hope they're looking at a growth industry. "These jobs represent the future of Michigan employment," Greg Main, the CEO of the Michigan Economic Development Corporation, said when the IT services provider Ciber hired 150 workers at its Detroit Global Solutions Center last year.

But building sustainable IT centers in any developed country is hardly a sure thing. A decade ago, global companies discovered that the well-trained IT workforce in Ireland would accept lower pay than IT employees elsewhere in Western Europe, and many set up service centers there. As the industry grew, however, the economic advantage proved to be unsustainable: The newcomer companies exhausted the supply of skilled workers, and wages rose.

Make sure you're the first company in a new location, and that local colleges can provide the talent you need.

Small U.S. and European cities could run into the same problem. An IT service center that needs hundreds of employees could tap out the talent supply in a city with only 200,000 people and just a few colleges and universities. If another company then opened a center nearby, our research suggests, wages could spike—and the value proposition could rapidly deteriorate.

So step number one in any onshoring decision is choosing the location wisely. Make sure you're the first company to move in, and look closely at the number and quality of local colleges: Can they provide enough graduates who have the skills you need? Consider government incentives carefully, too: They can shorten your breakeven time to just a few years, but subsidies eventually go away.

The second step is making sure that you're onshoring only work that is restricted or requires special skills or knowledge of legacy systems. That will preserve the long-term economic attractiveness of the center.

Step number three is minimizing wage pressures over time. That means keeping your employees fully engaged and ensuring their professional growth. A satisfied worker is less likely to leave. You should set up a retention program that both emphasizes the benefits of small-city life and allows employees to rotate to other parts of the company, so that those who want to experience working at the hub, for instance, can fulfill that desire.

If you implement all three steps successfully, you'll be able to prevent the local labor market from overheating. And that's the key to making your onshore IT services sustainable over the long term.

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Aditya Pande is a principal in McKinsey's Silicon Valley office.



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Defend Your Research

HBR puts some surprising findings to the test



Zakary Tormala is an associate professor of marketing at Stanford's Graduate School of Business.

Experts Are More Persuasive When They're Less Certain

The finding: When experts express uncertainty about their opinions, people find them more compelling.

The research: Zakary Tormala of Stanford Business School had subjects read a review that gave a new eatery four out of five stars. Half the subjects read a write-up by a professional food critic, and the other half, one by an amateur. Half of each group saw a review that was highly certain; the rest, a review that was tentative. The subjects were then asked how good they thought the restaurant would be. While the confident amateur inspired subjects to give better ratings than the uncertain one, the less assured expert prompted higher ratings than the certain expert.

The challenge: Do people actually mistrust confidence in experts? **Professor Tormala, defend your research.**

Tormala: We don't necessarily mistrust confident experts, but sometimes we're more persuaded by experts who are not confident. My collaborator Uma Karmarkar and I asked subjects what they'd pay for a meal at our fictitious restaurant, Bianco's. People who'd read the tentative professional review were willing to pay 56% more than people who'd read the highly certain professional review. But uncertainty had almost the exact opposite effect with amateur opinions. People who'd read a confident amateur review were willing to pay 54% more for a meal than those who'd read an uncertain amateur review.

HBR: What made the difference between a confident review and an uncertain one?

We were pretty explicit. The title said either "A Confident 4 out of 5 Stars" or "A Tentative 4 out of 5 Stars." The review's language was also adjusted. For example, the uncertain review said, "Having eaten there only once, I can't confidently give my opinion, but I give it a tentative 4 out of 5."

I'm trying to imagine a case in which an expert who was unsure of himself would win me over. Frankly, I can't.

Well, you have to separate confidence in facts from confidence in opinions. Research has shown that in court testimony, confidence makes an eyewitness more credible, that it can impact trial outcomes. But there is a right or wrong answer there. In our research, we're dealing with tastes and attitudes.

I still don't get how a reviewer who says "I'm pretty sure this is a great movie" would persuade me more than one who says "It's a must-see."

The phenomenon at work here is what we call expectancy violations. People expect experts to be confident. Violations of that expectation surprise them. We see that in our data. Subjects reported being more surprised by the uncertain experts and the confident amateurs. A surprise draws you in and makes you pay more attention. It gives the review more impact.

Have certainty and influence been studied much?

There's a ton of research on certainty and influence, but the vast majority of it focuses on how a person's certainty affects his or her openness to others' ideas. We're trying to focus on interpersonal dynamics, or how one person's certainty affects others. This is some of the first research in that domain.

What about CEOs, who should be experts on their companies? Are you saying that if they project uncertainty about their firms' prospects, they'll be more influential?

Yes and no. It would definitely make your ears perk up if a CEO expressed uncertainty about the business. But closer attention doesn't always lead to more persuasion. Remember that in our study, both write-ups gave four out of five stars, and what the reviewer had to say was compelling. If what you're saying is not compelling, it could backfire.

What makes a message compelling?

By "compelling," I mean relevant to the core argument. In another study, we had subjects read reviews that also gave four out of five stars, but their content wasn't really about the restaurant. They said things like "My friend and I laughed the

Key Number

Two groups of people read a professional food critic's positive review of a restaurant. Those who read an uncertain opinion were willing to pay 56% more for a meal there than those who read a confident opinion.

PEOPLE WHO'D READ A CONFIDENT REVIEW WOULD PAY ON AVERAGE

$12.13

PEOPLE WHO'D READ AN UNCERTAIN REVIEW WOULD PAY ON AVERAGE

$18.87

whole time. I liked the way the menu looked and the colors they used." That's not compelling. Even if it were interesting, it's not what makes a restaurant good or bad. Whether the reviews were confident or not, people didn't find them persuasive.

Where else do you want to take your certainty research?

One thing I've started looking into with some other collaborators, Jayson Jia and Mike Norton, is how people view potential. Our initial findings seem to show that people value high potential more than high achievement.

Does Uncertainty Generate A Premium in Pay?

People value potential more than achievement. Given identical stats for a veteran pro athlete's first five years of performance and a rookie's predicted five-year performance, study subjects chose to pay the rookie nearly $1 million more in year six.



That explains why a rookie quarterback like Sam Bradford makes more money than Super Bowl champ Drew Brees.

Sports are a great example. In one study, participants read the scouting report on a basketball player. Some read the actual stats for the player's first five years in the league; others read predictions for the first five years' performance. The numbers were identical. Then we asked, How much would you pay this player in year six? On average, people gave the veteran who had performed $4.26 million and the rookie who was projected to perform $5.25 million, over 20% more.

Rookie talent in general, not just in sports, seems vastly overweighted.

Exactly. If you present people with letters of recommendation for one job candidate described as "high potential" and another described as "high achieving," they'll find the letter for the high potential candidate more interesting and possibly more persuasive.

How can people be so thick?

Proven achievement is very certain. It's less surprising and less interesting to think about. Potential is uncertain and kind of exciting. You can imagine many outcomes. Maybe they'll do better than you expect!

OK, I have to ask: How certain are you about the validity of your research?

I think our findings tell us something important. But you never know what other variables could be in play here. The more we research this, the better we'll understand it.

I'll buy that.

You see? It works.

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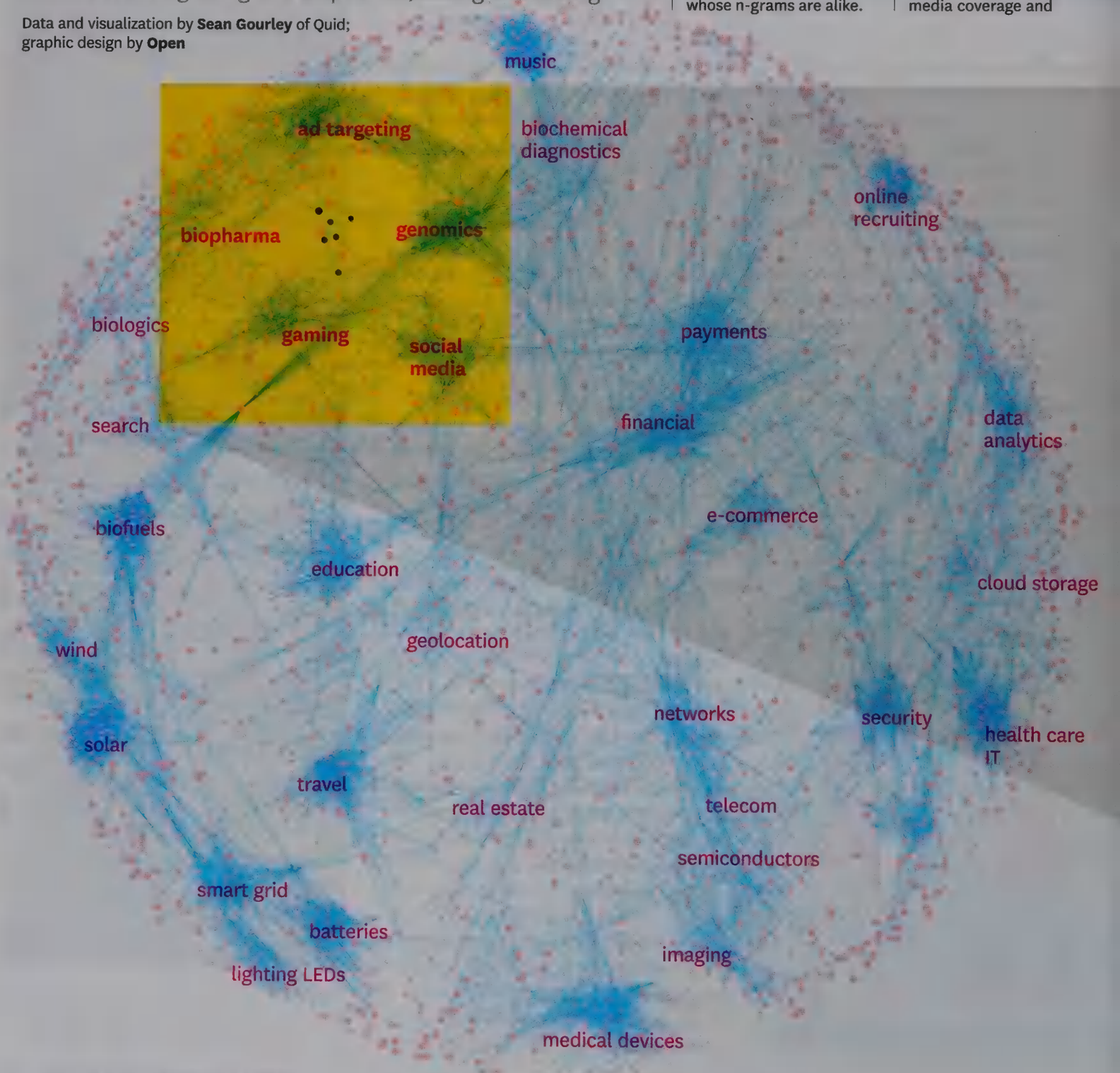
Locating Your Next Strategic Opportunity

Where and how do strategists find growth opportunities? Sometimes by literally drawing a map, using a technique called semantic-clustering analysis. Such maps can reveal not only which sectors are thick with competition but where in the market white spaces are open for the taking. For example, while it may seem odd to find opportunity in the nexus between gaming and biopharma, seeing is believing.

Data and visualization by **Sean Gourley** of Quid;
graphic design by **Open**

To map semantic clusters, Quid software first identifies hundreds of key phrases associated with individual companies and organizations, or their "n-grams." Applying algorithms and other analytical tools, the technology parses text in millions of corporate documents, from patent filings, to press releases, to Twitter posts. The software then creates a map with lines connecting companies whose n-grams are alike. The lines act like gravitational pull: The more lines there are between companies, the more tightly together those companies are drawn. Similar firms become clustered into industry sectors.

The result is a multidimensional industry map like the one below. It represents 4,000 technology enterprises—from venture-backed start-ups to established public companies—that received media coverage and



showed capital growth last year.

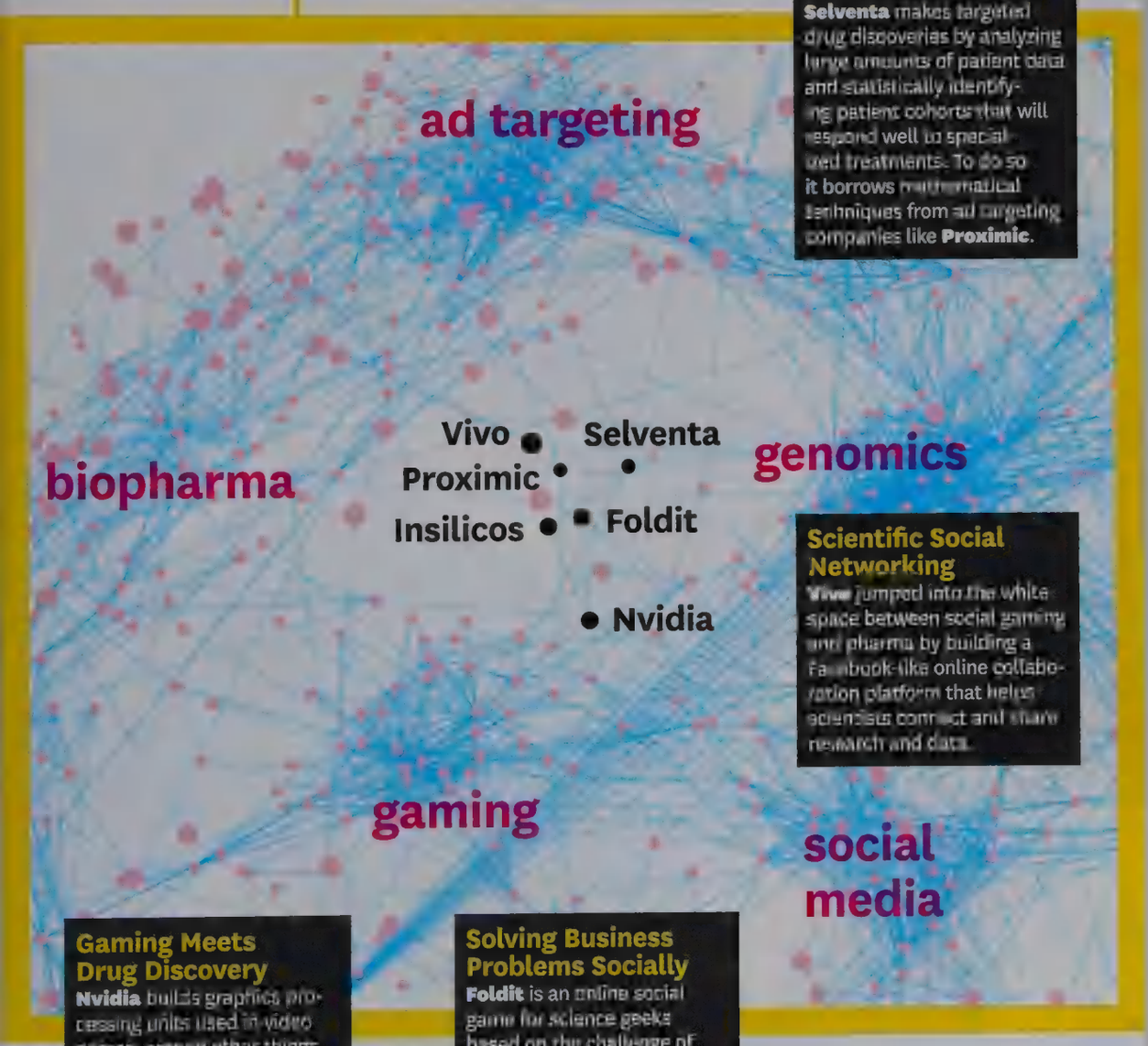
Such maps expose surprising relationships between and across sectors and, even more tantalizing, the white spaces among them—which can offer firms strategic opportunities to connect companies operating in different markets, to take existing products into new sectors, or to innovate with products and services no one has even dreamed up yet.

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The Pharma-Gaming Connection

One of the most intriguing white spaces on this map is surrounded by some industry sectors that at first glance may seem unlikely to be connected: biopharma, gaming, social media, and ad targeting. As shown in the box below, Selventa, Proximic, Vivo, Insilicos, Foldit, and Nvidia are some of the ventures seizing the strategic opportunities in this space.

Sean Gourley is CTO and cofounder of Quid, in San Francisco. **Open** is a design studio in New York.



Profiling and Personalized Medicine

Selventa makes targeted drug discoveries by analyzing large amounts of patient data and statistically identifying patient cohorts that will respond well to specialized treatments. To do so it borrows mathematical techniques from ad targeting companies like **Proximic**.

Scientific Social Networking

Vivo jumped into the white space between social gaming and pharma by building a Facebook-like online collaboration platform that helps scientists connect and share research and data.

Gaming Meets Drug Discovery

Nvidia builds graphics processing units used in video games, among other things. Recognizing that work done by biomarker discovery and diagnostic development companies like **Insilicos** requires similarly intense graphics processing, Nvidia has edged into the drug discovery space.

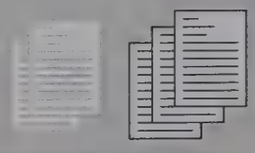
Solving Business Problems Socially

Foldit is an online social game for science geeks based on the challenge of finding the most efficient way to fold proteins. But the thousands who play it can help solve real protein-folding challenges for biopharma companies, which have begun putting the gaming platform to work.

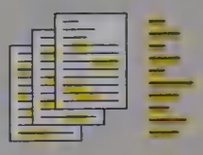
How N-Gram Mapping Works



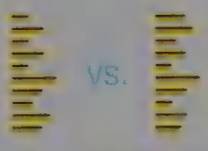
Semantic-clustering software locates and analyzes the documents in a company's digital footprint.



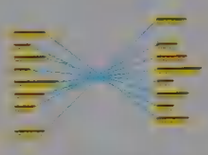
Documents are categorized and weighted for importance.



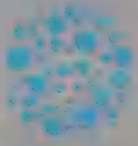
The software then identifies the company's n-grams, or key phrases.



The company's n-grams are then compared with other companies' n-grams.



When at least 80% of their n-grams are similar, companies are linked on the map.



The process is then repeated for every company in the sample to generate the map.

Strategic Humor

HBR.ORG To enter this month's contest, go to **hbr.org/magazine** and click "Cartoons from the current issue."





CAPTION CONTEST



"Sell."

This month's winning caption was submitted by **Sean Kelly**, of Fairfield, Connecticut.

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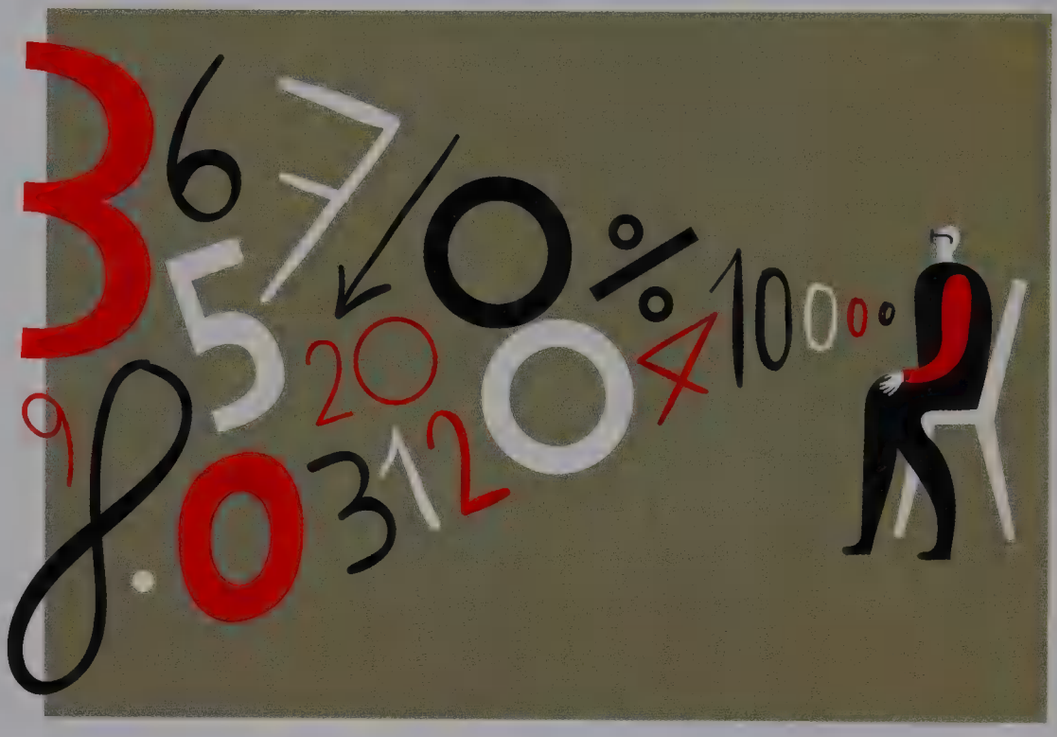
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Martin



Roger L. Martin is the dean of the University of Toronto's Rotman School of Management and the author of *The Design of Business* (Harvard Business Review Press, 2009).

Don't Get Blinded By the Numbers



Businesses love numbers. No strategy proposal is complete without a detailed spreadsheet translating recommended actions into profits. The ability to cook up those spreadsheets is one reason bright young managers go to business schools like Harvard and Stanford. They come out with finely honed quantitative skills and set to work applying them.

Over the past couple of decades this management-by-numbers game has gained currency. The huge amount of data captured by IT and the growing sophistication of econometric modeling encouraged nearly everyone to believe that a firm's success was driven by the quantity of its data and the ability to model them. I'm reminded of Isaac Asimov's science fiction trilogy in which a brilliant mathematician creates a model that charts the future of humanity.

Midway through Asimov's series, though, the model breaks down—and the same thing is happening in the real world, forcing educators to rethink how we're training tomorrow's business leaders.

> Although factors such as design and trust can't be reduced to numbers, they *can* be interpreted and understood.

More and more we're coming to see that strategy is as much about interpreting as it is about analyzing. When we look at the prospects of a car like the Mini Cooper, we must not only measure its fuel consumption and interior space but also take into account the beauty of its design and the exhilaration of driving it. We can quantify the revenue opportunities from impinging on the privacy of Facebook users, but we can't measure the betrayal those users feel.

Although factors such as design and trust can't be reduced to numbers, they *can* be interpreted and understood. In fact, only by understanding them can we make meaningful distinctions between alternative strategies or predict customers' emotional responses to a change in direction.

The best executives grasp this reality well. Take the former P&G CEO A.G. Lafley, who attributes the most successful decision of his career to a qualitative judgment. In 1990, as the general manager of laundry products, he had to decide whether to move to compact detergents, which were transforming the market in Japan. The new format would cut P&G's production, packaging, and transportation costs as well as retailers' shelf-space and warehouse needs, all while maintaining revenues.

Unfortunately, analysis of consumer surveys suggested that only a small percentage of customers preferred the new format. But Lafley dove into the qualitative information, reading comments from hundreds of consumers. He found that although only a few expressed a desire for compact detergents, the rest were indifferent—not negative. He could make the switch after all, pleasing the small minority without upsetting the majority, and delivering a big win for P&G. "The analysis never tells you the answer," he concluded. "The best it can do is to inform your judgment."

Lafley isn't alone. Increasingly, firms are putting aside data-driven approaches and borrowing from disciplines like ethnography. They study consumers interacting with products. They give consumers cameras and diaries to record their experiences. They even visit consumers' homes.

This kind of approach requires completely new capabilities. The successful strategists of the future will have a holistic, empathetic understanding of customers and be able to convert somewhat murky insights into a creative business model that they can prototype and revise in real time. To do all that, they'll have to be good communicators, comfortable with ambiguity and ready to abandon the quest for certain, single-point answers.

That's what business school deans like me have to work on teaching in the years ahead.

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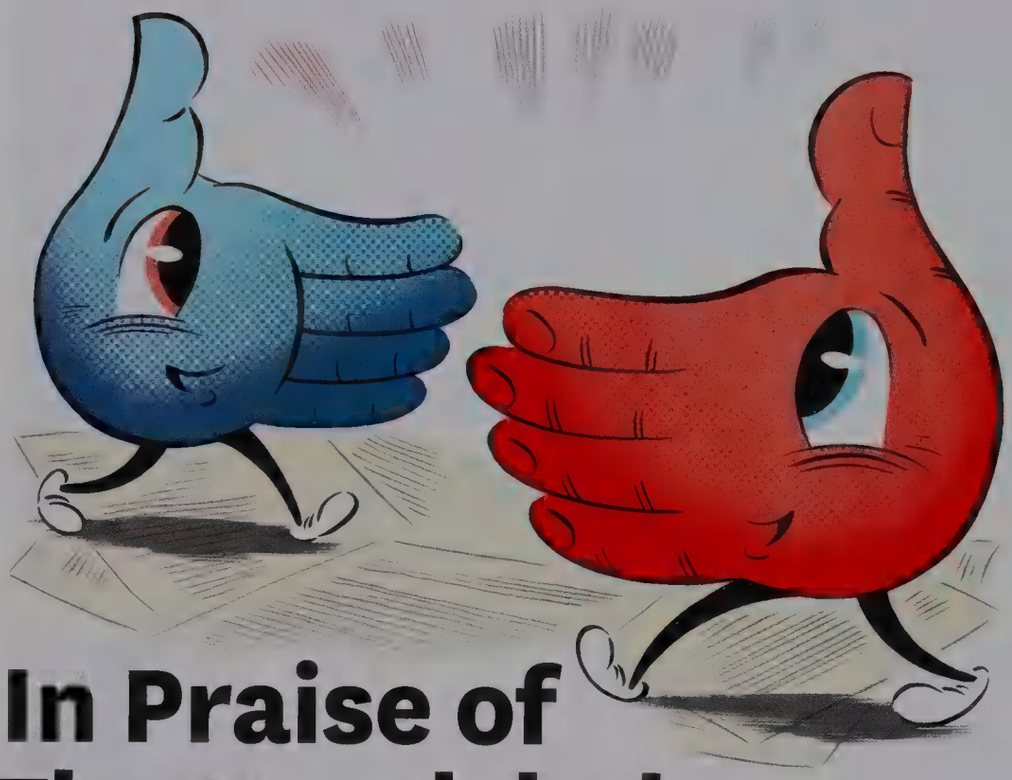
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Ariely



Dan Ariely (dandan@duke.edu) is the James B. Duke Professor of Behavioral Economics at Duke University and the author of *Predictably Irrational* (HarperCollins, 2008).



In Praise of The Handshake

Imagine that you and I meet at a party, and I tell you about my research on behavioral economics. You see opportunities to use the principles to improve your business and think we could work together. You have two options: You can ask me to collaborate, with a handshake promise that if things work out, you'll make it worth my while. Or you can prepare a contract that details my obligations and compensation, specifies who will own the resulting intellectual property, and so on.

For most of you, the decision is obvious. The second approach, the complete contract, is the way to go. But should it be?

The idea of making a deal with a handshake—what we generally call an incomplete contract—makes most of us uncomfortable. A handshake is fine between friends, but when it comes to vendors, partners, advisers, employees, or customers, we believe that incomplete contracts are a reckless way to do business.

Indeed, firms try to make contracts as airtight as possible—specifying outcomes and contingencies in advance, thus lowering the chances for misunderstanding and uncertainty. But complete contracts have their own flaws, and business's increasing dependence on (I would say, fetish for) absurdly detailed contracts in every situation comes with its own downside.

All contracts deal with the direct aspects of the expected exchange and with unexpected consequences. Incomplete contracts lay out the general parameters of the exchange (the part that we shake hands over), while the unexpected consequences are covered by social norms governing what is appropriate and what is not. The social norms are what can motivate me to work with you, and what would establish goodwill in resolving problems that might arise.

As for complete contracts, they too specify the parameters of an exchange, but they don't imply the same adherence to social norms. If something is left out, or if circumstances change, there's no default to goodwill—it's happy hunting season for all. When we use complete contracts as a basis for working together, we take away flexibility, reasonableness, and understanding and replace them with a narrow definition of expectations. That can be costly.

A CEO of a large internet company recently told me about one of the worst decisions of his career. He instituted a very specific performance-evaluation matrix that would determine 10% of his employees' compensation. Before this, the firm, like most, had a general agreement with its employees—they had to work hard, behave well, and were measured on certain goals. In return they were rewarded with salary increases, bonuses, and benefits. This CEO believed he could eliminate the uncertainty of the incomplete contract and better define ideal performance.

The complete-contract approach backfired. Employees became obsessively focused on meeting the specific terms of their contracts, even when it came at the expense of colleagues and the company. Morale sank, as did overall performance.

Even lawyers see the risks of complete contracts. As part of my research, I asked the dean of Duke's law school, David Levi, if I could take a look at the school's honor code. Expecting a detailed contract written by lawyers for lawyers, I was shocked to find that the code went something like this: If a student does anything the faculty doesn't approve of, the student won't be allowed to take the bar exam. It was, in essence, a handshake agreement!

> If something is left out of a contract, or circumstances change, it's happy hunting season.

"Imagine that a student decides to deal drugs and raise chickens in his apartment," Levi said. "Now suppose that our code of conduct bans many activities but doesn't address pot or chickens. The student has honored the code. But does Duke really want that student to become a lawyer?"

Complete contracts are inevitably imperfect. So what's better: a complete contract that mutates goodwill into legal trickery, or an incomplete contract that rests on the understanding we share of appropriate and inappropriate behavior?

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How I Did It...

Fadi Ghandour is the founder and CEO of Aramex International and was a founding partner of Maktoob.com, the world's largest Arab online community.

The CEO of Aramex On Turning a Failed Sale Into a Huge Opportunity



Aramex's Dubai (Jebel Ali Free Zone) sorting facility

by Fadi Ghandour

THE IDEA

Fadi Ghandour has built one of the most successful entrepreneurial enterprises to emerge from the Arab world, Aramex International, overcoming rejections, cash-flow crises, and naysayers in every country where he tried to do business.

In 1984, two years into building the express delivery company Aramex, I was preparing for the most important meeting I'd ever had. My partner, Bill Kingson, and I were hoping to persuade the Seattle-based Airborne Express to buy 50% of Aramex for $100,000.

At the time, out of a modest office in Amman, Jordan, we had launched several other small offices in the Middle East, hoping to become the first courier company based in that region. Our operations were tiny (we hadn't yet exceeded $1 million in revenue), I was personally playing a range of roles from chief salesman to occasional delivery guy, and the cash flow was uncomfortably tight. We were what I would describe as a guerrilla setup—a scrappy, hand-to-mouth business.

The Middle East was not yet seen as a growth opportunity for global courier companies: Skirting civil wars and complex political relationships was an enormous logistical and bureaucratic challenge. In addition, in some countries the business market wasn't yet demanding courier services; in others those services were monopolized by companies or the postal authorities. We thought that such an investment from Airborne, along with the explicit endorsement

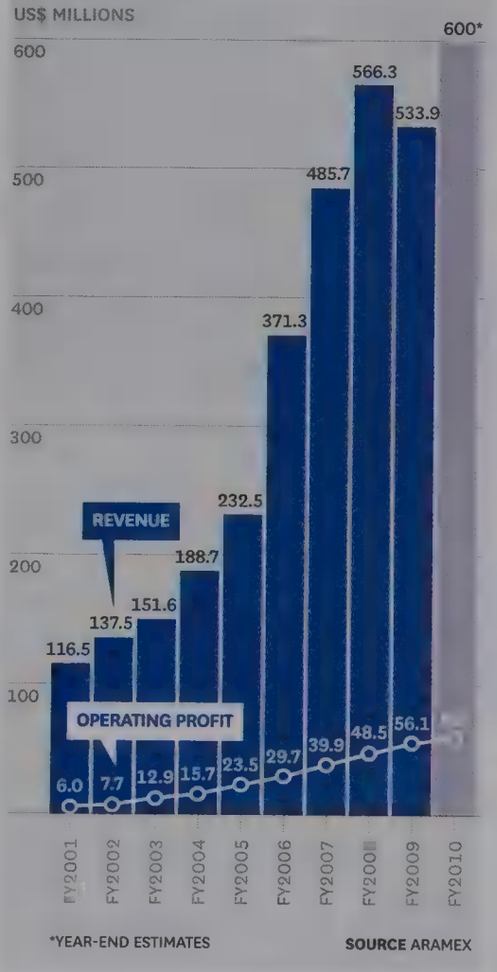


Airborne's offer meant that instead of getting a 50% owner, we would get a master class on how to grow our own business.

of one of the world's most respected logistics companies, could seal the future of our start-up.

Bill and I did get in to meet with both the CEO and the COO of Airborne Express, but they swiftly turned us down. Airborne was just starting to explore expansion outside the U.S. and wasn't ready to invest in a small market like the Middle East, let alone in a start-up. That was a huge disappointment to Bill and me. But we left the meeting with a valuable consolation prize: the promise of some business. At that time Airborne was occasionally asked to courier packages to various Arab countries; it would use either a competitor or some small London-based company to deliver in the region. Because the Middle East was such an insignificant part of Airborne's business, there would be little risk in giving those packages to Aramex. But to us it meant the largest and most important account for a long time. Our pitch had been that we could reliably handle whatever business Airborne acquired in the region—so it wouldn't have to turn to a competitor. We could be a neutral partner, acting on its behalf.

ARAMEX PROFITS & REVENUES



*YEAR-END ESTIMATES

SOURCE ARAMEX

I realized immediately that Airborne's offer would give us an opportunity to learn from one of the world's most successful courier companies—and, more crucial, to take advantage of its technology and global reach. Instead of getting a 50% owner, we would get a master class on how to grow our own business. That partnership would make the difference to our survival—and provide us with the rapid learning curve to set our own ambitions high. Nineteen years later, when Airborne was sold to its former archrival, DHL, not only had we learned everything we could from it, but we were ready to be a global leader in our own right.

"We Are Airborne Express...and Federal Express...and..."

Business from Airborne gave us enough credibility to knock on other doors. I realized that the prime competitors in the logistics and courier business feared one another more than they would fear us. So we sold our services as being provided by safe, neutral hands. We would call clients and say, "We are Airborne Express," or "We are Emery"—whatever company we were representing. We wore many hats and customized our services to suit whoever gave us business. If you looked back at the global offices of some of the major package-delivery companies in the 1980s and 1990s, you'd find some recurring addresses. Those were actually Aramex offices.

After knocking on the door at Federal Express time and time again, we finally gained it as a client in 1987. Aramex thus acquired its single largest account to date, because FedEx had more packages going into the Middle East than all its competitors combined, giving us a healthy monthly infusion of cash.

But our first serious relationship was to be our most significant. Airborne Express started to build a global alliance of regional courier companies like Aramex in order to offer customers service in every corner of the world without having to run or acquire all those operations itself. We were among the first of what would eventually be roughly 40 companies in the alliance—which was called Overseas Express Carriers (OEC)—whose responsibilities included establishing common operating procedures, rates, and quality assurance. Because Airborne provided its package-tracking technology to all its OEC partners, we had an enormous competitive advantage at a very low cost. (We also acquired e-mail early on, achieving a quantum leap in management efficiency.) Previously Aramex had relied on faxes and telex machines for tracking and tracing; we didn't have the resources or the expertise to create our own system. Suddenly we were part of a sophisticated global operation. We'd been given access



HBR.ORG Do you have questions or comments about this article? Fadi Ghandour will respond to reader feedback at **hbr.org**.

to similar systems from FedEx and Emery, but without permission to use them for our own Middle Eastern customers. Airborne's system elevated us to a whole new level of service.

Nevertheless, building a regional Middle East company in those days was a huge challenge. As I said, wars, invasions, and post office monopolies were often nearly insurmountable barriers to service delivery. Sometimes we had to operate under a freight-forwarding umbrella while we waited for a courier company license, or risk having our operations shut down by local officials. In Egypt that license would cost $80,000 a year—a hefty amount for a start-up. I was kept busy traveling around the region looking for partners that would do a joint venture with us, agree to represent us, or "sponsor" us. Our goal then was simply an office address, a couple of cars, and a phone; we outsourced customs clearance to agents and found other small courier companies to deliver whatever packages we had. The first five years of the company's life were spent making sure we had an office in each country so that we could perform the services our global clients required.

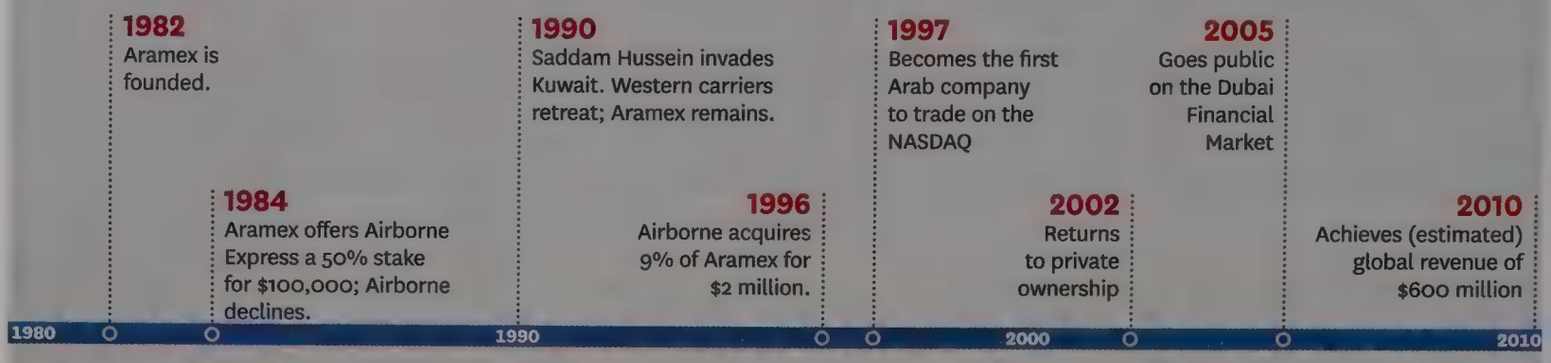
Adding Business Bit by Bit

But by 1994, with relative peace in the region, our business had reached $38 million in revenue and we could see enormous growth potential. Unfortunately, so could some of our biggest customers. Federal Express began cutting back on countries it wanted us to handle and setting up its own operations across the region. By then we already had an established brand and an indigenous customer base in the Middle East. Our strategy was to be cautious and stealthy. We started by focusing on small and midsize companies that were sensitive to cost. Our salespeople targeted clients that would give us direct business worth maybe $200 to $1,000 a month. We found that something as simple as a 10% discount over the competition—with our Airborne-granted ability to offer reliable tracking—was enough to win them over. It was grassroots sales: a shipment here, a shipment there, slowly building our revenue and number of clients.

At the same time, the global logistics industry was consolidating: FedEx and UPS had acquired companies such as Gelco and IML in Europe and Asia; Emery and Purolator had merged. FedEx bought Flying Tigers—an all-freight airline. In addition to expanding our presence geographically, we diversified our revenue stream by becoming a one-stop shop for freight forwarding;

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How Aramex Grew into a Major Player



shipping by air, sea, and land; and a variety of logistics services across the region.

We also focused on making the most of our participation in Airborne's OEC alliance. We stayed heavily involved in its governance for strategic reasons—we wanted to continue to develop our business relationship with Airborne and our alliance colleagues. We did joint sales calls with them. We pushed Airborne to bring us U.S. business in the Middle East. We seized every opportunity to learn what clients required and differentiated ourselves by offering customized services. We tried to align ourselves as closely as possible with Airborne; it may have looked to the outside world as if Airborne owned us.

In March 2004 Aramex went from hat-in-hand hopeful to global leader. It was a fantastic feeling.

By 1996 it did—at least a part of us. A little over a decade after we had offered 50% of our small company for $100,000, Airborne bought 9% for $2 million. It saw Aramex as a potential platform for going global without having to build its own Middle East operations from scratch.

The First Good Night's Sleep

Having a toehold in the Middle East was good for Airborne's serious global ambitions. For us, the deal was catalytic. Though by that point we had revenue of $52 million, our operating income was only $2.4 million. Worse, as is true for many entrepreneurs, our monthly cash flow was consistently precarious. With that $2 million in the bank, I had the first good night's sleep in 14 years. Up to that point my life had revolved around daily meetings about accounts payable, how much money we had in banks across the world, and how we could scrape and scrimp and pay. We had a somewhat justified reputation for being a late payer.

We immediately communicated to all our strategic suppliers that we were ready to better manage our payables with them. Until we got that $2 million, I hadn't actually been sure we could survive. Suddenly, instead of a hand-to-mouth start-up, we were a start-up that could pay its bills on time—and that already had hefty revenues. It put us in a great place to stabilize and grow the business.

After Airborne's investment, we tried to raise additional capital for expansion, thinking that we could attract regional investors interested in our growth story. But we failed, mostly because they could not understand our non-asset-based business model or grasp that a small company from the region could actually compete with the giants of the industry.

In July 1996 Bill said we should go public on the NASDAQ. My reaction was "You must be kidding!" But in January 1997, after some tough months of preparing to adhere to SEC requirements, we became the first company from the Arab world ever to go public on the NASDAQ. Our IPO was for only $7 million, but Airborne's name made a huge difference for us. In all our road shows we would talk about the partnership, and we could see that it gave U.S. institutional investors confidence in us. All of a sudden regional investors, too, were interested. We followed up with secondary offerings and ultimately raised a total of about $14 million.

Though we were still active in Airborne's alliance, that influx of capital allowed us to ramp up our own growth, and we didn't waste a minute. We were confident enough to start pushing the boundaries. We began moving into territories outside the Middle East, including India, Sri Lanka, Bangladesh, and Hong Kong. This aggressive expansion was a constant point of disagreement between us and Airborne as we became much more independent and less reliant on OEC partners in our operations.

We did fear losing access to Airborne's tracking system, which had carried us for more than 10 years. So I made building our own system the leading priority for the company. By 2000 we had recruited a good IT team that was busy creating the system internally and with outside vendors. The team got a boost when a senior Airborne employee in Europe, who had considerable global operations experience and intimate knowledge of the technology needed for tracking and tracing systems, decided to resign. That allowed us to recruit him, despite Airborne's discomfort. His job from day one was to focus exclusively on building the system with our technology team in Jordan, which took about two years.

Our Place in the Sun

In 2003 our preparedness plan paid off when, as we had long feared, Airborne announced that it was to be acquired by DHL.

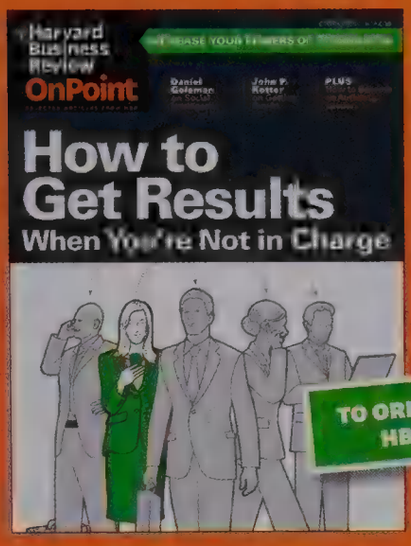
Airborne gave us nine months' notice that it would be withdrawing all its support and business from us. By then we had operations or skeleton operations in key markets and were only six months away from having a fully independent system for package tracking and tracing. Immediately after the announcement about Airborne's acquisition we called a meeting of the OEC partners in London. I stood up and said, "Listen, Airborne is going, but by the time it switches off, Aramex will be able to provide you with a tracking system that will maintain the alliance." We were ready to replace or take over every operation that Airborne was going to exit.

When Airborne actually switched off its systems, in March 2004, we said, "Thank you very much" and switched ours on. It was almost a nonevent. In that moment Aramex went from hat-in-hand hopeful to global leader. It was a fantastic feeling. We had learned and developed with our partners along the way, and now we were ready to lead.

In some ways it was a sad end to our relationship with Airborne, but within Aramex we were celebrating. We were truly an entrepreneurial company, and the partnership had prevented us from realizing our full potential. So we were finally going to take our place in the sun.

In January 2002 I had taken the company private again through a leveraged buyout in partnership with the newly formed private equity firm Abraaj Capital. This deal was the first of its kind in the Middle East and set the stage for a booming private equity industry in the region. In 2005 Abraaj exited the investment through an IPO on the Dubai Financial Market that was dramatically successful: We had wanted to raise $270 million, and we were oversubscribed by a factor of 64.

At year's end our 2010 global revenue was estimated at $600 million and our operating income at $60 million. Our market capitalization is now $900 million. What felt like a big disappointment in 1984 didn't work out so badly after all.



The Art of Informal Leadership

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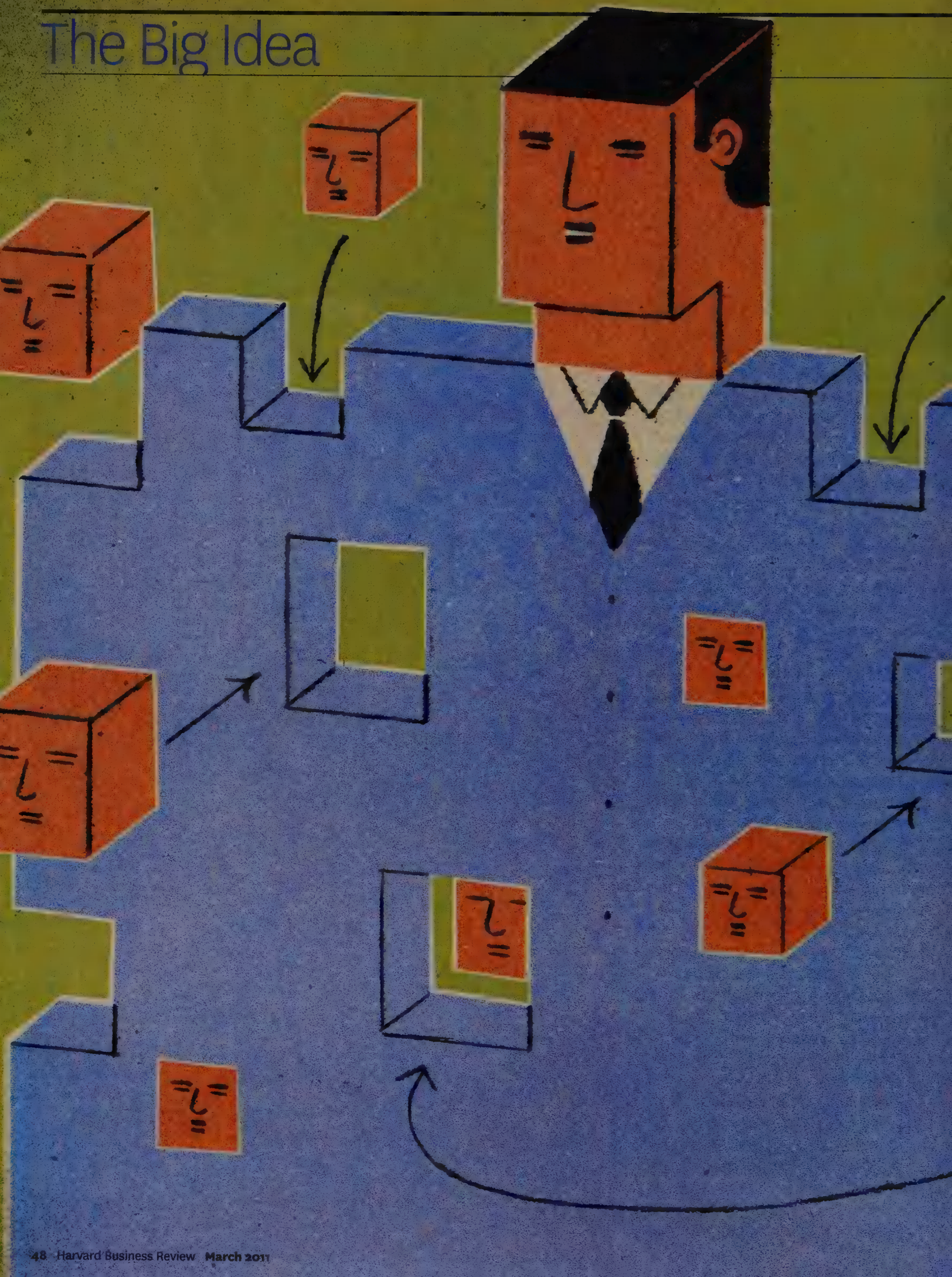
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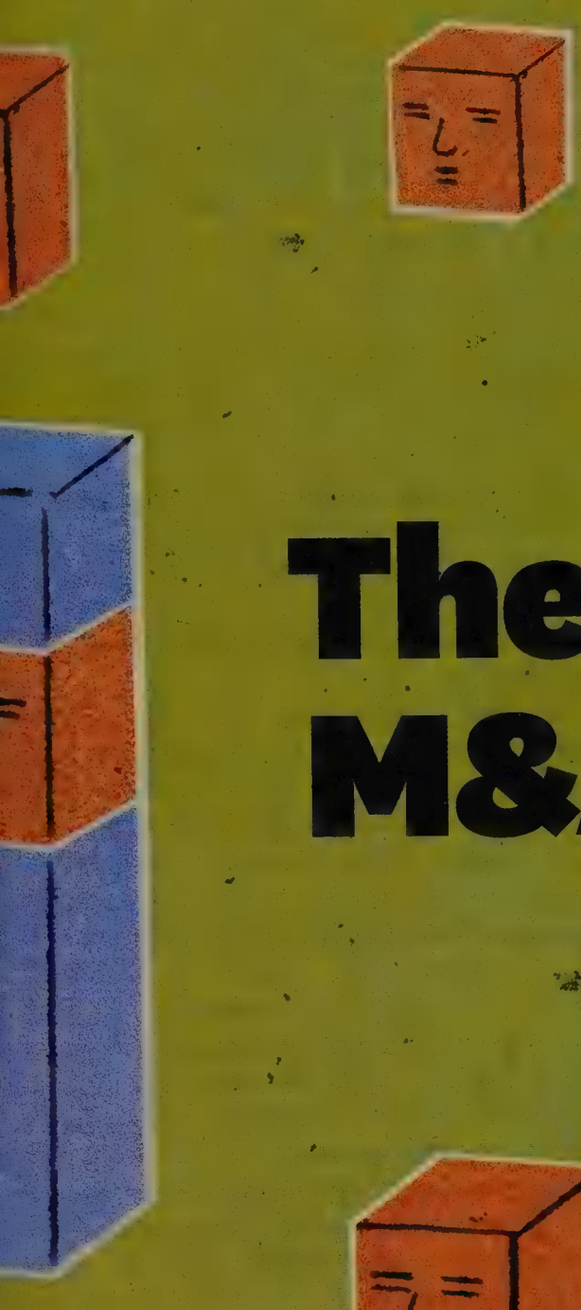
and more...

Whether you're a manager or not, at one time or another you've surely had to influence, or even improve, the performance of people who don't report to you. How can you motivate colleagues to help you complete a project? How can you convince your boss to go with your plan? How do you use social skills to build alliances? This issue of *Harvard Business Review OnPoint* offers a wealth of advice on how to think and act like a leader—even when you don't have formal authority.

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Why you should pay top dollar for a "killer deal"—and other new rules for making acquisitions

by Clayton M. Christensen, Richard Alton, Curtis Rising, and Andrew Waldeck

The New M&A Playbook

When a CEO wants to boost corporate performance or jump-start long-term growth, the thought of acquiring another company can be extraordinarily seductive. Indeed, companies spend more than $2 trillion on acquisitions every year. Yet study after study puts the failure rate of mergers and acquisitions somewhere between 70% and 90%. A lot of researchers have tried to explain those abysmal statistics, usually by analyzing the *attributes* of deals that worked and those that didn't. What's lacking, we believe, is a robust theory that identifies the *causes* of those successes and failures.



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Here we propose such a theory. In a nutshell, it is this: So many acquisitions fall short of expectations because executives incorrectly match candidates to the strategic purpose of the deal, failing to distinguish between deals that might improve current operations and those that could dramatically transform the company's growth prospects. As a result, companies too often pay the wrong price and integrate the acquisition in the wrong way.

To state that theory less formally, there are two reasons to acquire a company, which executives often confuse. The first, most common one is to boost your company's current performance—to help you hold on to a premium position, on the one hand, or to cut costs, on the other. An acquisition that delivers those benefits almost never changes the company's trajectory, in large part because investors anticipate and therefore discount the performance improvements. For this kind of deal, CEOs are often unrealistic about how much of a boost to expect, pay too much for the acquisition, and don't understand how to integrate it.

The second, less familiar reason to acquire a company is to reinvent your business model and thereby fundamentally redirect your company. Almost nobody understands how to identify the best targets to achieve that goal, how much to pay for them, and how or whether to integrate them. Yet they are the ones most likely to confound investors and pay off spectacularly.

In this article, we explore the implications of our theory in order to better guide executives in selecting, pricing, and integrating acquisitions and thus dramatically increase their success rate. The first step is to understand at a very basic level what it means for one company to buy another.

What Are We Acquiring?

The success or failure of an acquisition lies in the nuts and bolts of integration. To foresee how integration will play out, we must be able to describe exactly what we are buying.

The best way to do that, we've found, is to think of the target in terms of its business model. As we define it, a business model consists of four interdependent elements that create and deliver value. The first is the customer value proposition: an offering that helps customers do an important job more effectively, conveniently, or affordably than the alternatives. The second element is the profit formula, made up of a revenue model and a cost structure that specify how the company generates profit and the cash required to sustain operations. The third element is the resources—such as employees, customers, technology, products, facilities, and cash—companies use to deliver the customer value proposition. The fourth is processes such as manufacturing, R&D, budgeting, and sales. (For more on this business model construct, see Mark W. Johnson, Clayton M. Christensen, and Henning Kagermann, "Reinventing Your Business Model," HBR December 2008.)

Under the right circumstances, one of those elements—resources—can be extracted from an acquired company and plugged into the parent's business model. That's because resources exist apart from the company (the firm could disappear tomorrow, but its resources would still exist). We call such deals "leverage my business model" (LBM) acquisitions.

A company can't, however, routinely plug other elements of an acquisition's business model into its own, or vice versa. Profit formulas and processes don't exist apart from the organization, and they rarely survive its dissolution. But a company can buy another firm's business model, operate it separately, and use it as a platform for transformative growth. We call that a "reinvent my business model" (RBM) acquisition. As we shall see, there is far more growth potential in purchasing other companies' business models than in purchasing their resources.

Executives often believe they can achieve extraordinary returns by acquiring another firm's resources and so pay far too much. Alternatively, they walk away from potentially transformative deals in the mistaken belief that the acquisition is overpriced, or they destroy the value of a high-growth business model by trying to integrate it into their own. To understand why these mistakes are so common and how to avoid them, let's explore in more detail how acquisitions can achieve the two goals mentioned earlier:

- improving current performance
- reinventing a business model.

Boosting Current Performance

A general manager's first task is to deliver the short-term results investors expect through the effective operation of the business. Investors rarely reward managers for those results, but they punish stock values ruthlessly if management falls short. So companies turn to LBM acquisitions to improve the output of their profit formulas.

CAN THIS ACQUISITION HELP YOU COMMAND PREMIUM PRICES?

WHAT ARE the critical measures of performance that customers value in your product (speed, durability, functionality)?

WOULD MOST customers be willing to pay more if you improved the product on those measures? (Do they value the extra speed, longevity, or functionality enough to pay more for it?)

CAN THE resources of the acquired company substantially improve your product in ways that customers would pay more for?

Idea in Brief

Most M&As fail. That's because most acquirers don't know how to think systematically about what they're buying and what it might do for them. There is a better way.

If you want to extend your business but not fundamentally change how you compete, you should buy a company with resources that will strengthen your firm. Fold those resources into your existing business and eventually let the acquired business die. But be careful! Acquirers in this situation usually overpay.

To reinvent your business, you'll need a new business model to complement, extend, or replace your own.

Plug your best resources into the new company, including the technology and capital it needs to grow. Pay liberally: Successful new business models make a lot of money.

Almost nobody understands how to identify targets that could transform a company, how much to pay for them, and how to integrate them.

A successful LBM acquisition enables the parent either to command higher prices or to reduce costs. That sounds simple enough, but the conditions under which an acquisition's resources can help a company accomplish either goal are remarkably specific.

Acquiring resources to command premium prices. The surest way to command a price premium is to improve a product or service that's still developing—in other words, one whose customers are willing to pay for better functionality. Companies routinely do this by purchasing improved components that are compatible with their own products. If such components are not available, then acquiring the needed technology and talent—usually in the form of intellectual property and the scientists and engineers who are creating it—can be a faster route to product improvement than internal development.

Apple's $278 million purchase of chip designer P.A. Semi in 2008 is an example of just such an acquisition. Apple historically had procured its microprocessors from independent suppliers. But as competition with other mobile-device makers increased the competitive importance of battery life, it became difficult to optimize power consumption unless the processors were designed specifically for Apple's products. This meant that to sustain its price premium, Apple needed to purchase the technology and talent to develop an in-house chip design capability—a move that made perfect sense.

Cisco has relied on acquisitions for similar reasons. Because its proprietary product architectures continue to push the leading edge of performance, the company has acquired small high-tech firms and plugged their technologies and engineers into its product development process. (See the sidebar "Can This Acquisition Help You Command Premium Prices?")

Acquiring resources to lower costs. When announcing an acquisition, executives nearly always promise that it will lower costs. In reality, a resource acquisition accomplishes that in only a few scenarios—generally, when the acquiring company has high fixed costs, which allow it to scale up profitably.

A Word About Conglomeration

There is one category of deal making not addressed here: acquisitions that build or optimize the parent company's portfolio of businesses. Leveraged buyouts by private equity firms are the most prominent example of this kind of deal. Although many LBO firms try to add value to their portfolio companies through operational improvements, much of the actual value to the acquirer is created by the use of leverage and the accompanying tax shield. These deals more closely resemble a stock purchase than a strategic acquisition. Other investors, such as Warren Buffett of Berkshire Hathaway and Ian Cumming of Leucadia National, purchase businesses for similar reasons, albeit with much less leverage. Large conglomerate acquisitions are sometimes made to diversify the parent's portfolio rather than for strategic fit with its current businesses. GE's acquisition of NBC arguably fits this description. We do not question the value of such acquisitions, which can be considerable. But they are not the kind that can have a direct and transformative impact on a company's business model.

Whether they are called "roll ups," "consolidation of shrinking industries," or "natural resource transactions," these deals all succeed in the same way: The parent plugs certain resources from the acquisition into its existing model, jettisoning the rest of the acquired model and shutting down, laying off, or selling redundant resources. The performance boost results from using the target's resources in such a way that scale economics can drive down costs.

Here's a simple example: Many New England homes are heated with oil in the winter. Oil retailers typically make monthly deliveries. If one retailer buys a competitor that operates in the same neighborhoods, the parent is essentially buying the competitor's customers and can eliminate the duplicate fixed costs of two trucks that serve neighboring customers. Here the critical acquired resource is not the trucks or drivers, which the company does not need to serve the new customers; it is the customers themselves, and they are plug-compatible with the parent's resources, processes, and profit formula. That's why the deal will lower the acquirer's costs.

But if the heating oil company purchased a similar firm in a different city, the acquisition would replicate the parent's cost position in a new geographic area, not reduce it in either one. There might be some overhead efficiencies, but costs would be lowered far less than in the previous example because the oil retailer would need the acquired company's trucks to service its new customers.

One sees scale-enhancing resource acquisitions like the same-neighborhood oil company deal when a pharmaceutical company acquires another so that it can carry the acquired products through its high-fixed-cost sales channel, or when ArcelorMittal buys competing steel companies, transfers production to utilize excess capacity in its most-efficient mills, and then shuts down redundant mills. Oil and natural gas company Anadarko's 2006 acquisition of Kerr-McGee followed the same pattern. What made Kerr-McGee attractive was the adjacency of its oil fields to Anadarko's. The combined firm could operate those fields with the same network of pipelines, support ships, and other fixed operating assets. Had Kerr-McGee's fields been in the North Atlantic and Anadarko's in the Gulf of Mexico, Anadarko would have had to maintain independent fixed-cost networks to support both operations. This would have resulted only in overhead efficiencies and potentially greater managerial complexity.

To work out whether a potential resource acquisition will help lower your costs, you must determine whether the acquisition's resources are compatible with your own and with your processes (see the sidebar "Can This Acquisition Help You Lower Costs?") and then determine whether scale increases will actually have the desired effect.

For companies in industries where fixed costs represent a large percentage of total costs, increasing scale through acquisitions results in substantial cost savings, in the same way that the oil company could lower its costs by buying a local competitor. But in industries where cost-competitiveness can be reached at relatively low levels of market share, a company growing beyond that does not reduce its cost position but replicates it, as would a heating oil company that purchased customers in a different city. (See the exhibit "When Will Increased Scale Lower Costs?") In the polyester fabric industry, for example, once a firm is big enough to fully utilize a state-of-the-art air-jet loom, any growth in volume requires the producer to buy another loom. For companies whose cost structures are dominated by variable costs, resource acquisitions typically yield only minimal improvements to the profit formula.

Similarly, the benefits of scale are most substantial in operating categories that have a high percent-

CAN THIS ACQUISITION HELP YOU LOWER COSTS?

Predicting whether the resources of a prospective acquisition will improve the output of your company's business model, and so lower costs, is mainly a matter of assessing how compatible they are with your company's resources and processes.

RESOURCES

WILL THE acquisition's products fit into my product catalog without creating confusion?

DO ITS customers buy products like ours, and vice versa?

CAN THE output of the acquisition's factories be used with minimal adjustment by our supply chain and distributors?

DO OUR salespeople have the skills to sell the acquisition's products? Will they be excited to sell them?

PROCESSES

CAN THE acquisition's offering be sold according to our sales cycle?

CAN MY people readily service the acquired customers?

CAN ITS products be produced in our factories, and vice versa?

WILL THE quality of its offerings be enhanced by our rules for managing procurement, IT systems, and quality control systems?

If the resources of the target are compatible with your resources and processes, the acquisition will most likely improve the resource velocity of your profit formula—that is, there is a good chance it will improve turnover or utilization of assets and fixed costs.

age of fixed costs, such as manufacturing, distribution, and sales. Acquisitions that are justified by economies of scale in administrative costs such as purchasing, human resources, or legal services often have disappointing effects on the profit formula. When the *New York Times* acquired the *Boston Globe,* for example, there were few operating synergies (reporters and printing were by necessity separate). The administrative overlaps in areas like HR and finance were not enough to make this a good deal.

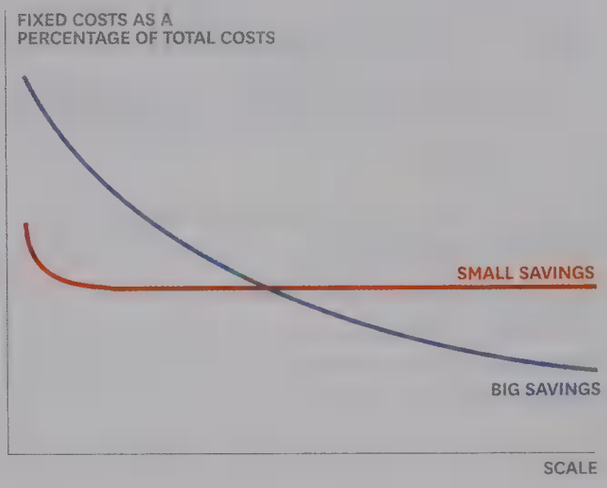
As a general rule, the impact of an LBM acquisition on the acquirer's share price will be apparent within one year, because the market understands the full potential of both businesses before the acquisition and has had enough time to assess the outcome of the integration and any synergies that may arise. Investors are often much less optimistic than CEOs about LBM deals, and history generally proves them right: The best-case result is a jump in share price to a new plateau. Some managers hold out hope that LBM acquisitions can unlock unexpected growth, but as we will see, they are likely to be disappointed.

The temptation of one-stop shopping. A word of warning is in order for companies seeking to boost current performance through LBM deals aimed at acquiring new customers: All the successful examples we've identified involve selling "acquired" customers the products they were already buying. Acquisitions made for the purpose of cross-selling products succeed only occasionally.

Why? Let's say Clayton Christensen is a typical shopper, who buys both consumer electronics and hardware. Wouldn't Walmart, which carries both product categories, have a better chance of winning his business than Best Buy, which sells only consumer electronics, or Home Depot, which sells only hardware? In a word, no. That's because Clay needs to buy electronics just before birthdays and holidays, whereas he needs to buy hardware on Saturday mornings, when he intends to repair something at home. Because these two jobs-to-be-done arise at different times, the fact that Walmart can sell him both kinds of products does not give it an advantage over the specialists. Typical shopper Clay does, however, buy gasoline and junk food at the same time—when he's on a road trip. Hence, we have seen a convergence of convenience stores and gas stations. In other words, an acquisition whose rationale is to sell a variety of products to new customers will succeed only if customers need to buy those products at the same time and in the same place.

When Will Increased Scale Lower Costs?

If fixed costs represent a large percentage of your total costs, you can reap substantial savings by increasing scale. But if your costs are more variable than fixed, scale increases may require new overhead investments and so deliver minimal savings.





Some managers hold out hope that buying another company for its resources can unlock unexpected growth, but they are likely to be disappointed.

Acquisitions won't improve the performance of a firm that's being commoditized. Nothing will.

CAN THIS ACQUISITION CHANGE YOUR COMPANY'S GROWTH TRAJECTORY?

IS THE acquired company's product or service simpler and more affordable than the established players' offerings?

DO THIS simplicity and affordability enable more people to own and use the product or service? Is it good enough to suit the needs of a variety of customers?

CAN THE acquired company's business model scale upmarket to yield a stream of progressively higher-capability products and services?

DO established players find the company's offering profitable enough to replicate, or is the company playing in low-end markets that incumbents are content to ignore?

DOES THE acquired company reposition you to capture the most attractive (future) profits in the industry's value chain?

More than once, ambitious executives, such as Sanford Weill of Citigroup fame, have assembled "financial supermarkets," thinking that customers' needs for credit cards, checking accounts, wealth management services, insurance, and stock brokerage could be furnished most efficiently and effectively by the same company. Those efforts have failed, over and over again. Each function fulfills a different job that arises at a different point in a customer's life, so a single source for all of them holds no advantage. Cross-selling in circumstances like these will complicate and confuse, and will rarely reduce sales costs.

Reinventing Your Business Model

The second fundamental task of a general manager is to lay the groundwork for long-term growth by creating new ways of doing business, since the value of existing business models fades as competition and technological progress erode their profit potential. RBM acquisitions help managers tackle that task.

Investors' expectations give executives a strong incentive to embrace the work of reinvention. As Alfred Rappaport and Michael Mauboussin point out in their book *Expectations Investing* (Harvard Business Review Press, 2003), managers quickly learn that it is not earnings growth per se that determines growth in their company's share price—it's growth relative to investors' expectations. A firm's share price represents myriad pieces of information about its predicted performance, synthesized into a single number and discounted into its present value. If managers grow cash flows at the rate the market expects, the firm's share price will grow only at its cost of capital, because those expectations have already been factored into its current share price. To persistently create shareholder value at a greater rate, managers must do something that investors haven't already taken into account—and they must do it again and again.

Acquiring a disruptive business model. The most reliable sources of unexpected growth in revenues and margins are disruptive products and business models. Disruptive companies are those whose initial products are simpler and more affordable than the established players' offerings. They secure their foothold in the low end of the market and then move to higher-performance, higher-margin products, market tier by market tier. Although investment analysts can see a company's potential in the market tier where it's currently positioned, they fail to foresee how a disruptor will move upmarket as its offerings improve. So they persistently underestimate the growth potential of disruptive companies.

To understand how that works, consider Nucor, an operator of steel minimills, which back in the 1970s developed a radically simpler and less costly way to make steel than the big integrated steelmakers of the day. Initially, Nucor made only concrete reinforcing bar (rebar), the simplest and lowest-margin of all steel products. Analysts valued Nucor according to the size of the rebar market and the profits Nucor could earn in it. But the pursuit of profit drove Nucor to develop further capabilities, and as it invaded subsequent product tiers, commanding higher and higher margins from its low-cost manufacturing technique, analysts kept having to revisit their estimates of the company's addressable market—and hence its growth.

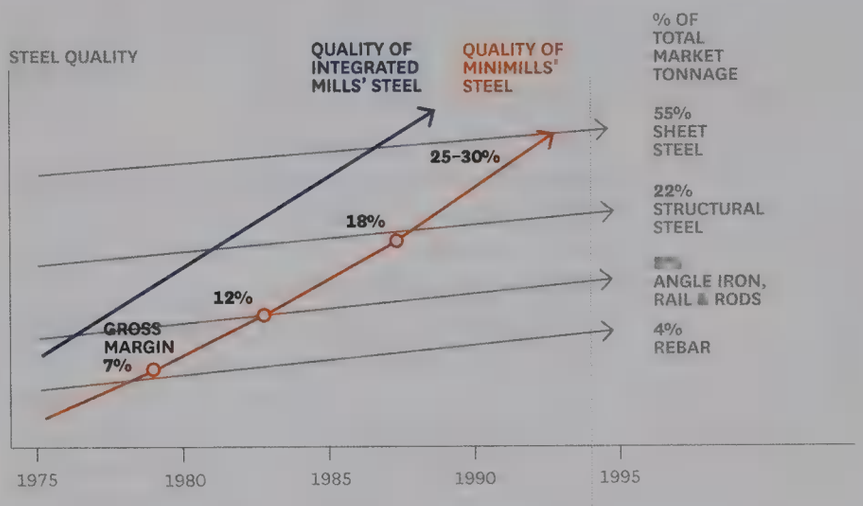
As a result, Nucor's share price fairly exploded, as the exhibit "Why Disruptive Businesses Are Worth So Much" demonstrates. From 1983 to 1994, Nucor's stock appreciated at a 27% compounded annual rate, as analysts continually realized that they had underestimated the markets the company could address. By 1994, Nucor was in the top market tier, and analysts caught up with its growth potential. Even though sales continued to increase handsomely, that accurate understanding, or "discountability," caused Nucor's share price to level off. If executives had wanted the company's share price to keep appreciating at rates in excess of analysts' expectations, they would have had to continue to create or acquire disruptive businesses.

A company that acquires a disruptive business model can achieve spectacular results. Take, for example, information technology giant EMC's acquisition of VMware, whose software enabled

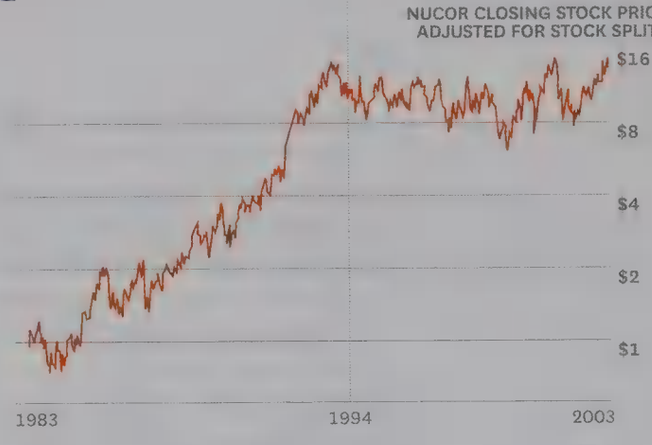
Why Disruptive Businesses Are Worth So Much

What produces a dramatic increase in a company's share price? Growth that investors weren't predicting. As Nucor developed revolutionary approaches to steel making, the company was able to enter increasingly larger segments of the steel market—each time prompting investors to reconsider Nucor's share price. Once there were no new markets to conquer, the company's share price leveled off.

AS NUCOR MOVES FROM LOW-END TO HIGH-END SEGMENTS...



...ITS STOCK PRICE EXPLODES.



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IT departments to run multiple "virtual servers" on a single machine, replacing server vendors' pricey hardware solution with a lower-cost software one. Although this offering was disruptive to server vendors, it was complementary to EMC, giving the storage hardware vendor greater reach into its customers' data rooms. When EMC acquired VMware, for $635 million in cash, VMware's revenues were just $218 million. With a disruptive wind at its back, VMware's growth exploded: Annual revenues reached $2.6 billion in 2010. Currently, EMC's stake in VMware is worth more than $28 billion, a stunning 44-fold increase of its initial investment.

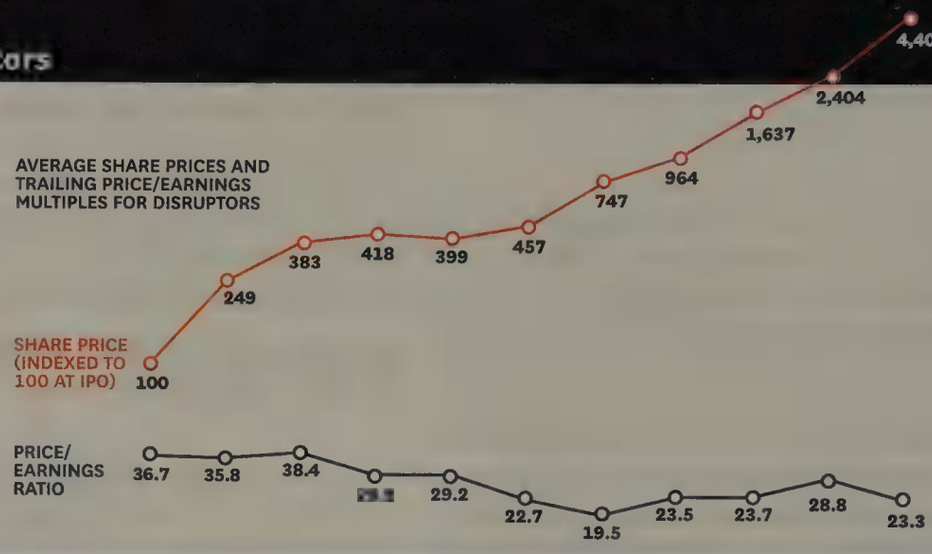
Johnson & Johnson's Medical Devices & Diagnostics division provides another example of how reinventing a business model through acquisition can boost growth from average to exceptional. From 1992 through 2001, the division's portfolio of products performed adequately, growing revenues at an annual rate of 3%. But during the same period, the division acquired four small but disruptive business models that ignited outsize growth. Together these RBM acquisitions grew 41% annually over this period, fundamentally changing the division's growth trajectory. (See the sidebar "Can This Acquisition Change Your Company's Growth Trajectory?")

Acquiring to decommoditize. One of the most effective ways to use RBM acquisitions is as a defense against commoditization. As we have described previously in this magazine, the dynamics of commoditization tend to follow a predictable pattern (see Clayton M. Christensen, Michael Raynor, and Matt Verlinden, "Skate to Where the Money Will Be," HBR November 2001). Over time, the most profitable point in the value chain shifts as proprietary, integrated offerings metamorphose into modular, undifferentiated ones. The innovative companies supplying the components start to capture the most attractive margins in the chain.

If a firm finds itself being commoditized in this way, acquisitions won't improve the output of its profit formula. In fact, nothing will. Firms in this situation should instead migrate to "where the profits will be"—the point in the value chain that will capture the best margins in the future. Right now, the business models of major pharmaceutical companies are floundering for a host of reasons, including their inability to fill new-product pipelines and the obsolescence of the direct-to-doctor sales model. Industry leaders like Pfizer, GSK, and Merck have tried to boost the output of their troubled business models by buying and integrating the products and pipeline resources of competing drugmakers. But in the wake of such acquisitions, Pfizer's share price plummeted 40%. A far better strategy would be to focus on the place in the value chain that is becoming decommoditized: the management of clinical trials, which are now an integral part of the drug research process and so a critical capability for pharmaceutical companies. Despite this, most drugmakers have been outsourcing their clinical trials to contract research organizations such as Covance and Quintiles, better positioning those companies in the value chain. Acquiring those organizations, or a disruptive

How the Market Rewards Disruptors

High price/earnings ratios (which indicate a high share price relative to net income or profits) in a sample of 37 disruptive companies led analysts to believe their shares were overpriced at the time of their IPOs. The extraordinary performance of these companies in the market, however, suggests that their shares were in fact persistently underpriced.



SOURCES COMPUSTAT, THOMSON REUTERS, BLOOMBERG

drugmaker like Dr. Reddy's Laboratories, would help reinvent big pharma's collapsing business model.

Paying the Right Price

Given our assertion that RBM acquisitions most effectively raise the rate of value creation for shareholders, it's ironic that acquirers typically underpay for those acquisitions and overpay for LBM ones.

The stacks of M&A literature are littered with warnings about paying too much, and for good reason. Many an executive has been caught up in deal fever and paid more for an LBM deal than could be justified by cost synergies. For that kind of deal, it's crucial to determine the target's worth by calculating the impact on profits from the acquisition. If an acquirer pays less than that, the stock price will increase, but only to a slightly higher plateau, with a gentle upward slope representing the company's weighted-average cost of capital, which for most firms is about 8%. In contrast, consider the exhibit "How the Market Rewards Disruptors," which charts the average earnings multiple of 37 companies we've determined to be disruptive in the 10 years after they went public. Annual P/E ratios for this group are far higher than historical levels, leading analysts to believe their shares were overpriced. Yet investors who purchased at the time of the IPO and held the stock for 10 years realized an astounding 46% annual return, indicating that the shares were persistently underpriced, even at these "high" multiples.

Analysts charged with determining the right price for a company's shares work hard to find appropriate comparables. For LBM acquisitions, the correct comparables are companies that make similar products in similar industries. For RBM acquisitions, however, such comparables make disruptive companies seem overpriced, deterring companies from pursuing the very acquisitions they need for reinvention. In reality, the right comparables for disruptive companies are other disruptors, regardless of industry.

Ultimately, the "right" price for an acquisition is not something that can be set by the seller, far less by an investment banker looking to sell to the highest bidder. The right price can be determined only by the buyer, since it depends on what purpose the acquisition will serve.

Avoiding Integration Mistakes

Your approach to integration should be determined almost entirely by the type of acquisition you've made. If you buy another company for the purpose of improving your current business model's effectiveness, you should generally dissolve the acquired model as its resources are folded into your operations. That's what Cisco does with the great majority of its technology acquisitions. (There are certainly exceptions: An acquired process, for instance, is sometimes so valuable or distinct that it substitutes for or is added to the acquirer's.) But if you buy a company for its business model, it's important to keep the model intact, most commonly by operating it separately. That's what Best Buy did with Geek Squad, running its high-touch, higher-cost service model as a separate business alongside its low-margin, low-touch retail operation. Likewise, VMware's server-focused business model was distinct enough

When Daimler folded Chrysler's resources into its operations, the real value of the acquisition disappeared.

from EMC's storage model that EMC chose not to integrate VMware very closely. EMC's original business model continued to perform well, but the addition of VMware's disruptive business model allowed EMC to grow at an exceptional rate.

Failing to understand where the value resides in what's been bought, and therefore integrating incorrectly, has caused some of the biggest disasters in acquisitions history. Daimler's 1998 acquisition of Chrysler for $36 billion is a quintessential example. Although the purchase of one car company by another looks like a classic resource acquisition, that was a fatal way to look at it. From about 1988 to 1998, Chrysler had aggressively modularized its products, outsourcing the subsystems from which its cars could be assembled to its tier-one suppliers. This so simplified its design processes that Chrysler could cut its design cycle from five years to two (compared with about six years at Daimler) and could design a car at one-fifth the overhead cost that Daimler required. As a result, during this period Chrysler introduced a series of very popular models and gained nearly a point of market share every year.

When Daimler's acquisition of Chrysler was announced, analysts began the "synergies" drumbeat—and Daimler responded that integrating the companies would strip out $8 billion in "redundant" costs. But when Daimler folded Chrysler's resources (brands, dealers, factories, and technology) into its operations, the real value of the acquisition (Chrysler's speedy processes and lean profit formula) disappeared, and with it the basis for Chrysler's success. Daimler would have done far better to preserve Chrysler's business model as a separate entity.

COMPANIES RIGHTLY turn to acquisitions to meet goals they can't achieve internally. But there is no magic in buying another company. Companies can make acquisitions that allow them to command higher prices, but only in the same way they could have raised prices all along—by improving products that are not yet good enough for the majority of their customers. Similarly, they can make acquisitions to cut costs by using excess capacity in their resources and processes to serve new customers—but again, only in the same way they could have by finding new customers on their own. And companies can acquire new business models to serve as platforms for transformative growth—just as they could if they developed new business models in-house. At the end of the day, the decision to acquire is a question of whether it is faster and more economical to buy something that you could, given enough time and resources, make yourself.

Every day, the wrong companies are purchased for the wrong purpose, the wrong measures of value are applied in pricing the deals, and the wrong elements are integrated into the wrong business models. Sounds like a mess—and it has been a mess. But it need not be. We hope that the next time an investment banker knocks on your door with a guaranteed fee for himself and the acquisition of a lifetime for you, you'll be able to predict with greater accuracy whether the company on offer is a dream deal or a debacle.

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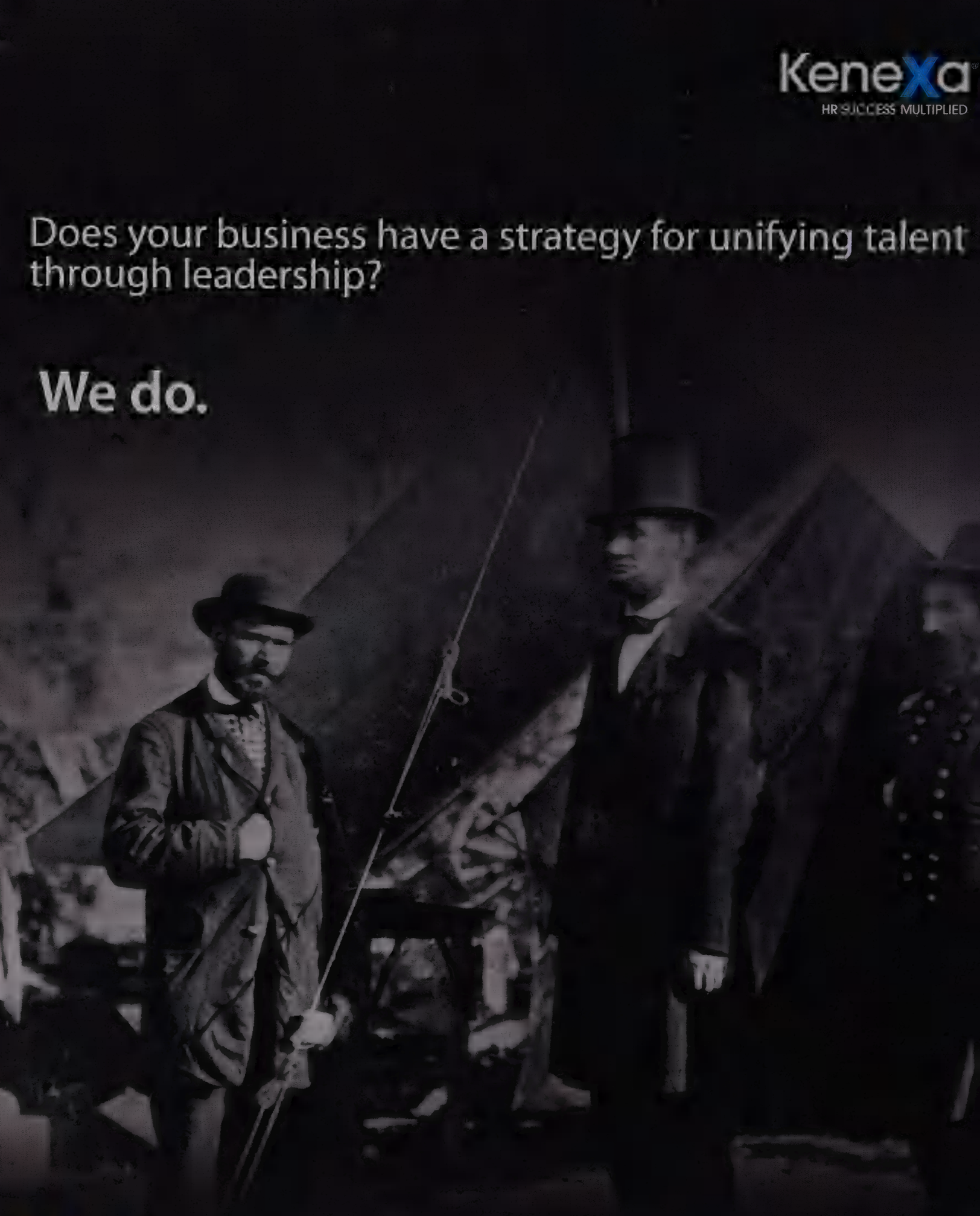


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Landing the Next Big Job

The route for getting where you want to go has changed dramatically in the past decade. Are you on the right path?



ARTWORK Leandro Erlich
Window and Ladder—Too Late for Help, 2008
metal ladder, underground building, metal structure, aluminum frames, fiberglass brick wall, 14.75' x 3.75' x 50'
installation at Prospect.1, New Orleans

Spotlight



ARTWORK Leandro Erlich, *The Staircase,* 2005
metal structure, wood, vinyl tiles, 14.75' x 11.5'

The New Path To the C-Suite



Are you ready for the big job? How the road to the top is shifting—and what changes lie ahead

by Boris Groysberg, L. Kevin Kelly, and Bryan MacDonald

WE KNOW that different times and different circumstances call for different leadership skills. So when it comes to managing your own career, how do you prepare yourself to move up? What abilities should young would-be executives focus on developing as they choose companies, functions, and jobs? And what skills should working executives hone as they strive to reach the next level?

Those aren't easy questions. The trends vary by function, geography, and industry—and, of course, by company. And though we can definitively identify the skills that companies seek now, pinpointing those that will be useful in the future is unavoidably speculative. Nevertheless, in examining hundreds of executive profiles developed over the past decade or so by the executive search firm Heidrick & Struggles and interviewing numerous top managers about the requirements for senior leaders past, present, and future, we have seen some clear signals about how C-level jobs are evolving.

One strikingly consistent finding: Once people reach the C-suite, technical and functional expertise matters less than leadership skills and a strong grasp of business fundamentals. Chief information officers need to know how to create business models; chief financial officers, how to develop risk management

> "I look at myself as a business leader and not as a CIO. I talk to my team about how to have different types of conversations. For instance, don't talk about how great the new smartphone is—talk about how it will increase sales calls, drive up revenue growth, and improve market share."
>
> —CIO, GLOBAL CONSUMER GOODS COMPANY

strategies; chief human resource officers, how to design a succession plan and a talent structure that will provide a competitive edge. In other words, the skills that help you climb to the top won't suffice once you get there. We're beginning to see C-level executives who have more in common with their executive peers than they do with the people in the functions they run. And today members of senior management are expected not only to support the CEO on business strategies but also to offer their own insights and contribute to key decisions.

In this article we'll explore this trend in more detail and explain other findings about skills required in each of seven C-level jobs—CIO, chief marketing and sales officer, CFO, general counsel, chief supply-chain-management officer, chief human resource officer, and CEO. We'll discuss the competencies that companies have sought over the past decade, those currently in demand, and those that, based on experience and early evidence, we expect to take precedence in the next decade. (For details on the methodology, see the "About the Research" box.) Our aim is to draw a road map of sorts for ambitious managers, to help them plot their next moves.

NEW REQUIREMENTS FOR THE CIO

Ability to view the business holistically, across functional, unit, and regional boundaries

Process orientation and comfort with organizational design

Information analytics knowledge; ability to help companies sort through and use information

Expertise in investment allocation and using ROI to make decisions about future IT expenditures

The Chief Information Officer

In the late 1980s and mid 1990s, most executives in information technology either had grown up in the function, following a standard path from business analyst to director, or were accounting professionals with systems experience. Typically, directorship was the end of the line. IT leaders were detail-oriented, logical, sequential thinkers. But toward the end of that period, as web opportunities burst onto the scene, companies began to seek more strategic ways to apply technology—using the internet to explore new markets, attract new customers, and streamline processes.

The typical IT director back then wasn't particularly well versed in business strategy or big-picture thinking. Technology departments had become too rigid and parochial to respond quickly to new business challenges and opportunities. IT directors by and large either pushed back with technical reasons for why something couldn't be done or agreed to requests too quickly without challenging their rationale or grasping their scope (and then frequently failed to deliver). Across geographies and sectors, serious barriers—in both leadership behavior and capability—were emerging between the business and technology functions. The few executives who could straddle both worlds were in high demand.

In the mid to late 1990s, in response to the lack of business savvy among the IT staff, a new position evolved—CIO. The CIO was a senior executive who understood not only new technologies but also how they applied to business strategy. These new members of the executive team were able to broker the complex relationship between business leaders and the IT department. They were less exclusively concerned with the technology itself and more attuned to how it could generate competitive advantage—and more focused on leadership and organizational effectiveness. Meanwhile, another phenomenon was emerging: globalization. IT managers had to deal with integrating and standardizing processes and platforms across multiple operating companies, group functions, and regions.

Then, in 2008, as credit began to dry up, business needs shifted again. Though IT had become better aligned with the business (at least when it came to improved relationships), IT executives now had to make complex decisions based on rigorous analyses of return on investment. Their jobs became less about managing projects well and more about managing the *right* projects well. Major technology expenditures needed to be justified. A number of CIOs found themselves in over their heads; the IT function required a leader who understood the increased complexity of business and how IT strategy, business strategy, risk management, and finance interacted.

For the foreseeable future, we expect the demand for a sophisticated mix of skills in CIOs will increase. Companies will seek "hybrid" CIOs who have not only business savvy but also experience with ana-

Idea in Brief

The skills needed for top jobs change with the times. The résumés of today's C-level managers look much different from those of their predecessors from 10 or 20 years ago.

For the senior-most executives, functional and technical expertise has become less important than understanding business fundamentals and strategy.

Top-team members now tend to have more in common with their executive peers than with the people in the functions they lead. Chief human resource officers, for instance, increasingly come from outside HR; IT executives now often benefit from a marketing background.

A recent study on executive recruiting offers insights on the new turns and twists in the road to the top.

lytics, organizational design, and infrastructure—and who know how to wire together a holistic system that can support global growth. In many cases, a commercial background will be a plus. Sales and marketing knowledge will be considered an advantage when it comes to e-commerce initiatives, as will stints in supply-chain management and logistics.

The most sought-after CIOs will have a keen understanding of how companies can put to use the oceans of information they now collect. As the CIO of a global consumer goods company explains, "There is a data explosion happening around us, but we feel we are well equipped to exploit this opportunity and use it as a competitive distinguisher in our markets. The ways we share our ideas and gain customer feedback are very new and exciting."

> "The global consolidation of sales and marketing will be instrumental in allowing us to serve our clients' needs in a more comprehensive way."
>
> —CMO, GLOBAL TECHNOLOGY AND SERVICES COMPANY

The Chief Marketing and Sales Officer

For most of the 20th century, the sales and marketing functions had narrow business charters and operated as silos. The two functions also tended to concentrate on different areas: sales on the business-to-business realm and on managing direct salespeople; marketing on the business-to-consumer realm. Marketing executives were almost exclusively responsible for creative, brand-driven advertising initiatives; sales executives were the proprietors of customer relationship management at the point of customer contact. Well-balanced, integrated marketing-and-sales organizations were rare; typically, one function had more power than the other.

At the turn of the millennium, marketing and sales still remained separate, but both began to broaden in scope as new channels emerged. Sales continued to overshadow marketing in B2B companies, but e-commerce initiatives forced sales leaders to grapple with some of the responsibilities that typically fell to marketing, such as how to deliver brand messages directly via the web. Demand for this expanded skill set gave rise to the VP of sales and marketing position, which became common in more and more companies.

A full decade later the lines between marketing and sales are continuing to blur. Trends like crowdsourcing are accelerating the innovation process, and social technologies, interactivity, and mobility have become integral to consumer media. Because marketing and sales must respond seamlessly to new opportunities, combined roles are increasingly prevalent.

The rise of a new role, chief commercial officer, reflects this shift. A 2009 Heidrick & Struggles study found that more than 200 CCOs had been appointed worldwide since the title first appeared a decade earlier; more than 50 of the appointments occurred in 2008 alone. The creation of the position attests to the CEO's need for a single point of contact on the commercial side who can manage innovation, product development, marketing, and sales—across all platforms, both digital and bricks-and-mortar.

NEW REQUIREMENTS FOR THE CHIEF MARKETING AND SALES OFFICER

- Significant in-sector experience
- Experience handling the marketing challenges and opportunities presented by new channels
- Ability to serve as the CEO's single point of contact for marketing, sales, and e-commerce
- Sophisticated technology know-how, as some distribution becomes more channel neutral; skill at managing relationships between commercial and technology executives
- Crisis and reputation management skills
- The ability to promote transparency and manage customer communities and public conversations

About the Research

To identify the critical traits of senior executives past, present, and future, we combined data analysis with studies of job descriptions created by knowledge management experts.

First, we examined executive summaries describing why companies were recruiting; for example, for the position of chief information officer, we read more than 100 profiles prepared for firms that were conducting searches. We focused in particular on the themes in the companies' job descriptions and how they ranked various competencies from "essential" to "nice to have." We charted the data first on a timeline (from 10 years ago to the present), then by sector, and finally by geography. Second, we asked search consultants in each function to speculate about what the future held for the positions we were surveying. To gather information on future requirements for CIOs, for instance, we convened several members of search firms' information technology practices to discuss changing business needs (such as balancing innovation with simplified computing utility) in light of new technologies. Finally, we corroborated our analysis and gathered additional insights by conducting interviews with executives who were serving or had served in the roles in question.

NEW REQUIREMENTS FOR THE CFO

Experience that matches a company's current needs—M&A experience for a company in growth mode, for instance, or a strong background in controls for a company that has experienced restatements or earnings violations	
Somewhat reduced focus on accounting skills and increased focus on strategic thinking	
Skill at finding the link between accounting and new business models and strategy	
Understanding of risk and how to balance it with performance	
A stronger outward focus, particularly when it comes to investor relations (though CFOs still need to be good overseers on the accounting front)	
A global, as opposed to country-specific, approach to finance	

Technology—in particular, digital channels as touch points—will continue to dominate marketing and sales strategy in the future. The demand for segmentation capabilities will grow as firms address a more diverse population of customers who expect tailored products and solutions as well as higher levels of service. Marketing and sales executives will be managing a workforce that has grown up in the digital age and catering to a customer base that has an ever-increasing desire for speed and easy interaction.

The Chief Financial Officer

Prior to the early 2000s the typical CFO was a bean counter, responsible mainly for reporting the numbers, measuring performance with integrity and accuracy, and managing the company's checks-and-balances processes. CFOs had accounting and financial acumen as well as strong quantitative skills, but their purview was relatively narrow and confined mostly to their department. The typical CFO was also country-centric, even at firms with an international presence, operating on the theory that regulatory differences made global finance too complicated.

Today, however, regional differences loom larger than ever, and multinationals no longer have the luxury of keeping finance issues within geographical boundaries. Managing a company's financials has become increasingly complex. Most large companies have a head of accounting team up with the CFO, who in turn plays a much more strategic role.

As the CFO of a large U.S. retailer explained it to us, a decade ago he was a good "steward" but saw the business more through an accounting lens than through strategy and value-creation lenses. That is not the case for most CFOs today. The top finance job now involves helping the CEO and business heads find new opportunities and assess their strategic and financial merits and risks. Because risk management has gotten much more corporate attention—first in anticipation of Y2K and later in the aftermath of 9/11 and business scandals—the chief of finance has stepped up to become the CEO's partner in making ambitious but rational choices on a wide range of issues. A once-obscure discipline, risk management has squarely hit the executive agenda, and CFOs had better be ready for it.

> "I think many CFOs a decade ago were probably great 'stewards' but saw the business more through an accounting lens versus a strategy and value-creation lens."
>
> —CFO, LARGE U.S. RETAILER

The top finance job demands a far broader background than it used to. As the retired head of finance of one U.S. manufacturer pointed out to us, CFOs now need experience with capital markets, mergers, and information technologies. In many businesses, CFOs are asked to play a more active role in managing external stakeholders and in investor communications in particular. They're also expected to have experience in operations and other corporate functional areas—and to encourage their subordinates to pursue cross-functional paths to broaden and deepen their teams' skills.



"More-sophisticated corporations look to a balanced general counsel to be a facilitator, someone who can play different roles—crisis manager, mergers expert, catalyst."

—EXECUTIVE RECRUITER

The CFOs of the future will operate around the globe, in multiple time zones, and will regularly partner with nonfinancial areas of the business on growth initiatives and international expansion. Thus they will need both a commercial sensibility and a global mind-set. (Some of the best companies now give their finance leaders international assignments to make sure they develop such a mind-set.) And whereas today CFOs are required to develop and implement systems and processes for budgeting and performance metrics, tomorrow they'll also be required to provide the management team with real-time operational and financial data and analyses. They'll continue to perform the traditional functions of managing the finances, reducing costs, and putting in place the appropriate controls, but strategic thinking will become more important. One retired chief financial officer believes that for the future CFO, "being a major contributor to the firm's competitive advantage will be more essential than the compliance aspects of the traditional role."

The General Counsel

Twenty years ago, with some rare and notable exceptions, the general counsel role was not a powerful or influential one. The move from a law firm to in-house counsel was regarded as the "soft" option; in-house lawyers were often deemed second-class citizens in the legal profession. They worked shorter hours and made less money. They kept an eye on regulatory compliance, closed deals, reviewed documents, and dealt with employee issues. The most challenging and important issues were typically sent to outside counsel.

As it did with CFOs, the heightened attention to risk management broadened the role of general counsels over time. Safety, security, and reputational risks all became central to the senior team's agenda. Companies began to seek legal officers who were adept at anticipating and mitigating them before they attracted public scrutiny. Increasingly, firms insisted that the top lawyer be at the table to discuss new initiatives so that their risks would be thoroughly analyzed before rollout. Many general counsels also became viable candidates for the job of CEO—evidence of their growing role as business partners.

With these changes the general counsel position began to shed its image as a soft job. Because regulatory scrutiny has intensified so much, GCs now are under more pressure and work just as hard as, and often get paid more than, partners in law firms.

To land a general counsel job today, a lawyer needs experience negotiating with legal and regulatory agencies and industry watchdogs—in the U.S., groups like the Department of Justice, the Financial Industry Regulatory Authority, the Securities and Exchange Commission, the Federal Trade Commission, the Treasury Department, and the Office of the Comptroller of the Currency (a bank regulator). And whereas corporate lawyers were once expected to understand just the rules at home—the assumption was that legal expertise didn't travel across national borders well—CEOs today need lawyers who can operate across geographic boundaries.

A sterling external reputation and a robust outside network—in particular, connections with government agencies and authorities—will often tip the scale in a given candidate's favor. In heavily regulated industries or ones with a substantial amount of

NEW REQUIREMENTS FOR THE GENERAL COUNSEL

- Business acumen
- Ability to interact with the board
- Experience managing an internal legal function
- Ability to negotiate with regulators and watchdog agencies
- Strong external network
- Judgment needed to outsource legal work appropriately and cost-effectively
- Knowledge of new environmental regulations and green considerations

bet-the-company courtroom action, litigation experience is attractive, though corporate law tends to be the background of choice in some other industries.

We'll see a continuation of the trend toward general counsels who report directly to chief executives and function as high-level advisers to CEOs and their boards. To manage outside law firms, general counsels will have to develop new strengths in strategic and business knowledge, financial skills, and collaboration. They will also need the agility to explore alternative fee models while maintaining the quality of legal services provided. Amy Schulman, Pfizer's general counsel, exemplifies the new, more versatile breed. She led a major reorganization of the company's legal division and spearheaded the creation of the Pfizer Legal Alliance, a group of 19 law firms that are compensated on an annual fee, rather than billable hour, basis and are expected to share information on Pfizer's legal business. Recently, Schulman became the business lead for Pfizer Nutrition, a unit that provides infant formulas and other products for children in more than 60 countries.

Corporate counsels as a whole will need the drive and skill to deal with a range of new and evolving challenges, like content piracy, privacy, and environmental initiatives. Though the role of general counsel will continue to attract senior partners from law firms, companies will be more reluctant to pull executives straight from private practice, preferring candidates with in-house experience who understand how to manage the people and finances of a legal department and how to operate as part of an executive team.

To help prepare their graduates for the new challenges, law schools have begun offering more business-focused and international legal courses. Fluency in multiple languages and cultural awareness are also key new skills for general counsels.

The Chief Supply-Chain-Management Officer

Two decades ago supply-chain management consisted of a handful of disciplines that were not systematically linked, and at the turn of the millennium that was still largely the case. However, as companies expanded internationally, separately handling the different aspects of SCM, such as purchasing and warehousing, started to become expensive and ineffective. The challenge of cost reduction forced SCMOs to pursue strategic sourcing and to build collaborative relationships with suppliers. CEOs thus looked for SCMOs who knew how to achieve cost efficiencies and possessed operational and outsourcing expertise. But 10 years ago SCMOs still rarely reported directly to the CEO; the function was somewhat removed from the concerns of top management.

> "I have my people work as extended business partners with the other business units as part of cross-functional teams. Supply-chain leaders should be thinking about the whole enterprise rather than 'It's not my function.' The goal is to influence a broader discussion instead of a myopic silo perspective."
>
> —CHIEF PROCUREMENT OFFICER, GLOBAL AIRLINE

Since then the role of the SCMO has changed. Today supply-chain management links the process end to end: Planning, procurement, manufacturing/operations, and logistics work together to devise economical solutions. The SCMO is expected to know all four functions thoroughly and to create an environment in which they share knowledge and work together smoothly.

Sustainability is also rapidly becoming a business imperative for executives who manage this function. Companies are finding that they can create value by executing and sharing sustainability strategies throughout their supply chains, from suppliers to customers. That trend is driving managers toward increased transparency; the greater the collaboration across the supply chain, the more benefits the company discovers.

In the future SCMOs will continue to be expected to pursue low costs through ever more diverse sourcing, both onshore and off. They will need to manage long-distance logistics and transportation, taking into account unpredictable external factors that could have a major impact on costs, such as political instability or the price of oil. Because they will also partner with CIOs to invent new ways for their companies to interact with customers and suppliers, SCMOs will have to be technologically savvy. Beyond all that, they will need to be big-picture thinkers who can participate in strategic and operational decisions

NEW REQUIREMENTS FOR THE CHIEF SUPPLY-CHAIN-MANAGEMENT OFFICER

- End-to-end understanding of the supply chain
- Cost-conscious exploration of outsourcing and internal solutions
- Ability to partner with the CIO to improve interactions with customers and suppliers; technical savvy
- Experience running a business unit, managing a P&L, and interacting with customers
- Ability to collaborate across all business units and global functions and with the support organization

at the highest level. Since SCMOs will be active and equal members of the executive team, experience in running a business unit, managing a P&L, and interacting with customers will serve them well.

As they meet the heady pace of change, companies will continually adjust their business models. In order to revise their supply practices accordingly, SCMOs will need experience in organizational design. International experience will grow more critical in the job, too, as global distribution becomes more commonplace and more competitive. SCMOs will need to understand emerging markets, which will often force them to embrace innovation. Distribution and logistics challenges in India, for example, are so complicated and challenging that ordinary solutions fall short there.

The Chief Human Resource Officer

Despite widespread acknowledgment that talent is integral to competitiveness, HR still struggles to gain clout in the C-suite. The HR role has long been viewed as largely administrative, except in the most forward-thinking companies, and its leaders have mostly been relegated to managing policies and cultural initiatives.

In the early 2000s, as globalization hit full force and multinational companies from mature markets expanded further into developing countries, hiring and managing talent became more complicated. Cultural differences created internal tensions and confused recruiting efforts—making strong talent programs more vital than ever. Because it's difficult to compare leaders from vastly different markets, companies began to acutely need personnel development systems that could be applied in a variety of settings. Nonetheless, at many companies HR still has something of a PR problem—and, with few exceptions, appears largely to react to rather than shape changes in the business world.

Some of the fault clearly lies with CEOs, who typically fail to define what they expect from their CHROs. And although compliance, risk, and executive compensation all belong on the CEO's agenda, many CEOs do not understand how to leverage the HR function to help address those topics. As Howard Schultz, the CEO of Starbucks, was quoted as saying in the *New York Times*, "The discipline I believe so strongly in is HR, and it's the last discipline that gets funded. Marketing, manufacturing—all these things are important. But more often than not, the head of HR does not have a seat at the table. Big mistake."

But there are signs of change. Instead of turning to career HR practitioners, companies are increasingly filling the CHRO role with leaders from functions on the business side, such as operations, marketing, or corporate law. One financial services company, for instance, which has long pointed to its sophisticated HR practices as a key source of competitive advantage, recently appointed a legal professional as its CHRO, in large part in response to the complex regulatory environment. Legal issues, in fact, are consuming more and more of HR executives' bandwidth—often to ill effect. Another financial services firm has seen a marked rise in turnover of late as its CHRO has been forced to spend most of her time dealing with regulatory and compensation issues, leaving other parts of the HR job undermanaged.

If companies continue to award top HR jobs to non-HR executives, the CHROs of the future will be more likely to have an understanding of commercial models, as well as experience with change management and finding pragmatic solutions to complex issues. And they will put extra pressure on HR specialists in functions like talent management to shift their focus from theory to business management.

As companies make more cross-border acquisitions, HR leaders will have to become more culturally and internationally astute. Ideally, they will have lived and worked in several regions. Such experience will give them a more nuanced understanding of how dissimilar cultures interact and help them make the most effective use of people with very dif-



"A good bellwether of the state of HR will be the function's ability to produce candidates from within its own ranks to take on senior roles at companies."

—EXECUTIVE RECRUITER

NEW REQUIREMENTS FOR THE CHIEF HUMAN RESOURCE OFFICER

- Commercial acumen
- Understanding of cultural differences and shifting demographics
- Change management skills; facility with cultural change initiatives
- The credibility needed to act as an internal adviser to the CEO and the board
- Ability to work with the board to manage succession
- Technological savvy
- Expertise in building compensation and performance into governance structures
- Skill at marketing the CHRO position to the rest of the organization

HBR.ORG Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

> "The critical functions for today's CEO are to listen, listen, listen...and communicate, communicate, communicate."
>
> —EXECUTIVE RECRUITER

ferent backgrounds. It will also help them create a high-performing organization with the least possible disruption—a tall order.

In general, because of changing workforce demographics, HR executives will have to be comfortable managing a staff that is more diverse. They will need to adeptly juggle the needs and contributions of experienced boomers, eager millennials, and professionals from emerging economies, to name a few.

Compensation will continue to be a hot topic, and not just in the financial services industry. Grounding in global remuneration practices and in the financial modeling, taxation, accounting, and legal issues surrounding compensation will help HR leaders build their companies' capabilities and gain credibility with senior leadership teams and boards of directors. The heads of HR also must be integrally involved in designing and implementing leadership succession plans—a matter that is woefully neglected in the majority of companies.

It may sound cliché, but attracting and developing top talent is the most important job of the CEO, and the chief HR officer should, in partnership with business heads, lead the charge.

The Chief Executive Officer

Many people have written about how the CEO role has evolved, so we won't go into depth here. We did, however, note a few trends that are influencing the direction the job is going in. First, it's less and less common for board members to be selected by the CEO, as boards and their nominating committees have assumed primary responsibility for director recruitment. However, it's now more common for the CEOs to owe their jobs to the boards rather than to their predecessors. That shift will mean more accountability at the top. Interestingly, boards have also become a source of CEO candidates. Over the past year there was a notable jump in the number of CEOs who were recruited from their company's board, according to an October Newswire article.

Second, the types of skills increasingly in favor are strong communication, empathy, collaboration, and trust building. One skill that will be of foremost importance will be the ability to elicit public trust as the face of the company. That will include facility and credibility with socially responsible initiatives.

ONE THEME that ran consistently through our findings was that requirements for all the C-level jobs have shifted toward business acumen and "softer" leadership skills. Technical skills are merely a starting point, the bare minimum. To thrive as a C-level executive, an individual needs to be a good communicator, a collaborator, and a strategic thinker—and we think the trend toward a general business orientation over a functional orientation will continue. A CEO would now count on a CIO, for instance, to weigh in on a discussion about expansion into a new market and how the firm's systems could support that expansion. What would the challenges be? What would be the long-term impact of the IT expenditures required to support the expansion? The CIO would be expected to provide answers to those questions.

Going forward, C-level executives will not simply manage their own business areas; they will be active members of the firm's senior leadership who advise the CEO on key decisions. As one executive recruiter put it, "The C-level person today needs to be more team-oriented, capable of multitasking continuously and leading without rank, and able to resist stress and make sure that his subordinates do not burn out. And he needs to do all of this with a big smile in an open plan office. In other words, we're looking at a whole new breed of top executive."

HBR Reprint R1103C



Almeri Cruz
Spotlight Artist
Each month we illustrate our Spotlight package with a series of works from an accomplished artist. We hope that the lively and cerebral creations of these photographers, painters, and installation artists will infuse the pages with additional energy to amplify what are often complex and abstract concepts.

This month the Spotlight artist is **Leandro Erlich,** whose work depicts versions of our everyday experiences that are cleverly altered to reveal paradoxical illusions.

View more of the artist's work at **skny.com/artists/leandro-erlich**.

Boris Groysberg is an associate professor of business administration at Harvard Business School and the author of *Chasing Stars: The Myth of Talent and the Portability of Performance* (Princeton University Press, 2010). **L. Kevin Kelly** (kkelly@heidrick.com) is the chief executive officer of Heidrick & Struggles. **Bryan MacDonald** (bmacdonald@heidrick.com) is a partner at Heidrick & Struggles.



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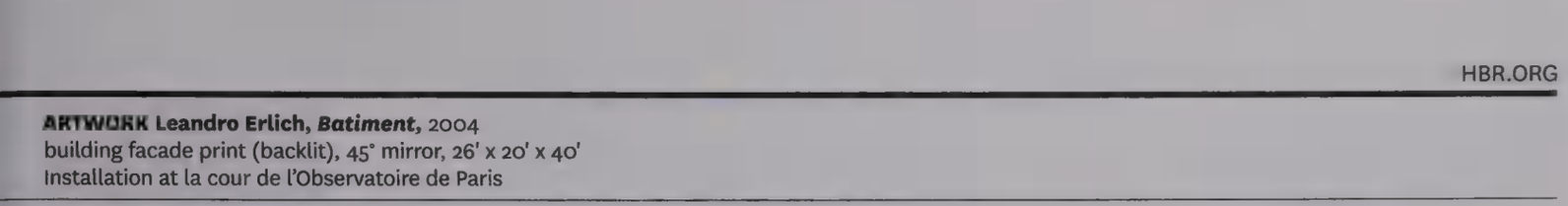
*Based on cumulative total return, 127 of 171 (74%), 138 of 160, 120 of 136, and 74 of 88 T. Rowe Price funds (including all share classes and excluding funds used in insurance products) outperformed their Lipper average for the 1-, 3-, 5-, and 10-year periods ended 12/31/10, respectively. Not all funds outperformed for all periods. (Source for data: Lipper Inc.)

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Spotlight





ARTWORK Leandro Erlich, *Batiment*, 2004
building facade print (backlit), 45° mirror, 26' x 20' x 40'
Installation at la cour de l'Observatoire de Paris

Developing Your Global Know-How

Multinationals such as Siemens, CEMEX, Walmart, and Samsung need executives with overseas prowess to manage far-flung operations. Here's how these companies cultivate the right combination of skills.

IT'S A RITE OF PASSAGE FOR UP-AND-COMING EXECUTIVES: the first overseas assignment. But the conventional multinational approach—offering experienced managers plum overseas jobs with rich expat packages—is becoming less prevalent. The Great Recession has forced many companies to cut back on assignments abroad. Some firms are using shorter stints, often done far earlier in a manager's career, to give workers global experience without requiring them to relocate. Others are pushing workers to really engage with the foreign culture they're in, instead of living an insular expat lifestyle.

HBR spoke about the global talent challenge with the top human resources executives at four multinationals: Siemens, CEMEX, Walmart, and Samsung. In these interviews, conducted by Cornelia Geissler and Lothar Kuhn from HBR's German language edition and HBR senior editor Daniel McGinn, the executives explain how their companies are adapting their strategies for a changing world.

Edited excerpts of the interviews follow.

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PHOTOGRAPHY: LEANDRO ERLICH STUDIO

SIEGFRIED RUSSWURM ON HOW TO EMBRACE A FOREIGN POSTING



SIEMENS

Siegfried Russwurm was Siemens's top human resources executive from 2008 to mid-2010, when he was promoted to run the company's industrial sector.

HBR: How big is your pool of global managers?

RUSSWURM: We are active in more than 190 countries around the world, which makes globally minded executives vital for us. To rise above a certain management level, we require experience abroad. Generally, I divide our 400,000 employees into three groups. The vast majority work their entire careers exclusively in their home country. The second group includes managers who are sent abroad for three to five years. Finally you have a group of truly global executives, whose office could be anywhere in the world. They know that their next job will be in another different country. We have about 300 of these truly global executives. Altogether, we have about 2,000 managers who've relocated abroad—about the same number as a decade ago. Back then the vast majority were Germans. Today 38% are other nationalities.

Have the conditions for expat managers gotten worse during the global economic crisis?

No. You're not going to get rich, but we offer fair conditions. We make sure that somebody sent to Singapore, for example, can maintain the same standard of living as in Munich. However, there is no specific financial incentive to go abroad—and we don't want anybody to take the job merely for the money.

Does every expat really try to integrate into the culture of the new posting?

No. Take, as an example, a German manager who's been posted to Shanghai. You can lead a true-blue German lifestyle in China: You can live in a gated community, with German neighbors. They will tell you where you can find a German bakery and butcher. And at work you can probably speak a lot of German, since many Chinese workers are proud that they have mastered a little of their employer's language. So when I interview someone for their next job, I ask if they maintain any contacts from their time abroad. Some will tell you they meet regularly with other expatriates they met abroad. Others will tell you about the Chinese friends they made. Those are completely different indicators of international thinking.

Are expats who return to Germany automatically promoted?

We're not allowed to promise promotions beforehand. That would be an invitation to just kick back and relax during one's time abroad. In general we offer a promise of reintegration—to try to find an appropriate position for returnees.

Do you see high turnover among expat managers, as many companies do?

No. It has to do with our company culture. It might be different with smaller companies, which can't offer expensive support for managers who are relocating. There are other factors, too. In some countries, such as the U.S., the connection to a company is traditionally not as strong, and the willingness to switch jobs can be greater regardless of whether the employee was a manager abroad.

At a Glance

SIEMENS

Total Employees
405,000

Employees Abroad
277,000

Total Revenue (2010)
$102.9 billion

Revenue Abroad
$87.5 billion

When I interview people, I ask if they maintain any of their contacts from abroad.

ILLUSTRATION: BODEBRICK MILLS



LUIS HERNÁNDEZ ON WHY EXPAT ASSIGNMENTS SUCCEED—OR FAIL

Luis Hernández is the senior vice president of organization and human resources at CEMEX.

At a Glance

CEMEX

Total Employees
46,881

Employees Abroad
32,790

Total Revenue (2009)
$14.5 billion

Revenue Abroad
$11.4 billion

HBR: Who are CEMEX's global managers?

HERNÁNDEZ: Right now we have about 100 executives in our expat program. About 30% of them will stay abroad in their next assignment. Our expat program is probably the smallest it's been in 10 years. In 2005 we had close to 400, and usually we have around 200. For most of the past decade we were going through a period of very rapid expansion; then in the past two years we've been in consolidation.

Describe the average participant.

Generally these people are in their 40s or 50s. When we began expanding internationally, in the 1990s, 90% were from Mexico, but today about half are from other countries. Many serve as country managers or heads of strategic planning for a business unit.

Have these always been coveted assignments?

No. Until recently the expatriate culture in Mexico was not well developed. Motivating people to move was difficult. They'd say, "You're sending me outside my country—I'm not used to it." Moving abroad for your company is much more common in Europe and the U.S. But executives have begun seeing it as part of their career development—particularly executives between 35 and 45. They've also seen the success of people who've been in the program, and they've heard from other expats about the positive experiences. Some of the fear has started to dissipate. Today being offered an expat position is good news.

What are the financial incentives to go abroad?

Expats get a foreign service premium equal to a 10% increase in salary. Some get a hardship premium, depending on the country; it ranges from zero in a relatively comfortable posting to, for example, 30% in Bangladesh. We pay for their housing. We pay for their children's schooling up to college. There's home leave—a ticket back to their home country for the entire family once a year. There are language lessons for the spouse. And we gross up the pay of all expats, to take out the potential effects of local tax law. Say you have an executive who earns $150,000. This person would cost close to $300,000 as an expat. It's expensive, but it can be very valuable. In the initial stages of the assignment, when the individual starts looking at the business and observing things from new angles and changing things to improve profits, you can get the money back pretty easily.

What's the key to a successful global assignment?

The first thing you need is a clear idea of the value the person brings to the receiving country. If the expat is going to be head of production, he needs to have very strong competence in that area. Second, it has to be someone who has CEMEX in his DNA—he has to understand the company's process worldwide. The other variables are personal and family perspectives.

Why do some assignments fail?

Typically there's a family adaptation issue. The spouse would like to move back, and that's a very difficult situation to manage. Eventually it doesn't work. Another situation is when you have an executive who's moved abroad, he's been in the position for several years, and the value of the assignment starts to diminish. There may not be another new assignment for him, and sometimes it gets difficult to bring him back to a high-level job. When that happens, we have ways out. We can put the executive into a localization program, where the expat financial package phases out and he remains in the same job. Otherwise our policy is to repatriate him and give him six months to find a position in the home market. If not, he'll leave the company.

You're describing your expat executives as male. Are there any females?

In general our executive base has a historical bias for males, given the nature of our industry. But we do have women in the program—of our 100 expats, around five are women.

Is it hard to retain these workers?

In the past couple of years, turnover has gone up a lot. When you have a program that goes from 400 people down to 100, you get a lot of turnover, because it's difficult to find space for these executives. But if we go through a normal cycle, where the number of expats doesn't change overall, the turnover reduces significantly—it's usually about the same as in the rest of the company.

Walmart



Susan Chambers is the executive vice president of Walmart's People division.

SUSAN CHAMBERS ON THE VALUE OF SHORT-TERM GLOBAL ASSIGNMENTS

HBR: Walmart began expanding internationally 20 years ago. How has its approach to global talent management changed during that time?

CHAMBERS: In the past, most global experiences were expat assignments. Those have been useful, and we'll continue to have expat assignments. But what we're more interested in is giving people additional experiences that don't necessarily require them to move for two or three years. One example is what I call Action Learning Groups. Say we have a specific problem we want to solve. In the past, we might have gone to a consulting group to help us. Now we're sending teams out to the region to solve it—for instance, a manager in Chile with M&A experience might be assigned to work on a deal in China. This gives people an opportunity to work cross-functionally in other countries and to gain some international exposure. We're also starting to have groups of employees do short internships in various countries to learn and share best practices. Right now these global internships last 12 weeks. In both of these programs we're trying to catch people earlier in their careers, compared with typical expat assignments.

Why do shorter-term assignments make sense?

There are a lot of people who want and need global experience who'd never get it if they had to sell the house and move the kids. Women may be disproportionately affected by these limitations. The more creativity we can bring to bear, the more we can reach down into the organization and the more women, in particular, we can get to participate.

How do these individual experiences add value to Walmart?

Consider one example. We have an associate named Seong Ohm. She's currently senior vice president of our home, hardlines, and entertainment group in our U.S. Walmart business. She just returned from an 18-month expat assignment in Japan, where she was in a senior merchandising role. She has two children. While she was in Japan she had an opportunity to serve as a female role model, showing what it meant to be a global leader in Japan. That was enabling for the workforce there. Now she's bringing that experience back to the U.S. business, and she's mentoring a group of expats who are getting ready to go abroad. She's doing her own version of an immersion program to get them ready.

Is it a challenge to relocate global workers to and from a rural headquarters in Arkansas?

Bentonville is a great place to raise a family, and that has universal appeal. We offer a great quality of life, and I'm amazed at how international this community is today. There are certain things—unique foreign foods, for instance—we may not have. But we've continued to add amenities, and we're amazingly appealing no matter where you come from.

In November Walmart offered to acquire 51% of the shares of Massmart Holdings Limited, which owns nine retail chains in sub-Saharan Africa. This investment would accelerate Walmart's growth and expansion in South Africa. Are employees interested in assignments there?

We have had people step forward and want to be involved in that business, whether it's part of the integration team that will eventually be sent over, or whether it's long-term employment. People stop me in the hallways and send me e-mails. The same goes for India. The purpose that guides Walmart is to help save people money so they can live better, and while that's been well-articulated as an ad campaign, the "live better" part really gets our people emotionally engaged and connected. You're talking about going into countries that have not had an opportunity to enjoy high-quality goods at a price people can afford. One of the things about the global talent we have the privilege of managing is that they want to make a difference.

At a Glance

WALMART

Total Employees
2.1 million

Employees Abroad
700,000

Total Revenue (2010)
$408 billion

Revenue Abroad
$100 billion

KEUMYONG CHUNG ON TRAINING PROGRAMS FOR EMPLOYEES HEADED ABROAD

Keumyong Chung is the head of Samsung's corporate human resources planning group.



HBR: Samsung has a lot of global employees, but how many truly global managers do you have?

CHUNG: We consider about 3,000 employees to be our core global managers. About half of them are local employees, and half of them are Korean expatriates. The number of expats is up dramatically from a decade ago. In 2001 we had only about 800. The number of overseas employees of all ranks has nearly tripled over that time.

In general, are executives more or less enthusiastic about relocating abroad?

They're very willing. Global experience is considered imperative for career success, especially in the sales and marketing function.

When an overseas posting fails, what's the most common cause? Is there anything specific that Samsung has done to reduce the failure rate?

The most common causes are failure to adapt to a different culture, lack of competency, and lack of communication skills. To prevent unsuccessful assignments, Samsung is currently operating various education programs. We have a cross-culture training program that tries to get executives familiar with the culture they'll be entering. We're doing more preassignment language training. We're doing more of what we call preassignment task focus training, to get people better prepared for the specific job they'll be doing abroad. And we put expats through a leadership course during their assignment.

We try to allow people to gain global experience earlier in their careers.

At a Glance

SAMSUNG

Total Employees
190,000

Employees Abroad
95,000

Total Revenue (2009)
$119.1 billion

Revenue Abroad
$106 billion

Are there specific markets where you're finding it difficult to place executive talent, and if so, why?

We have particular difficulty placing managers and their families in emerging regions where they are unfamiliar with the culture or there is political instability.

Are you becoming more reliant on local managers instead of expats to run your businesses?

Yes. With Samsung's higher global status and overseas business growth, the number of local team leaders has been consistently rising. From 2009 to 2010, it rose from 63% to 68%. This is a change from the past, when Samsung's overseas operations were mainly run by Korean expatriates.

Has Samsung begun offering alternatives to long-term expat assignments?

We have several shorter-term assignments to try to allow people to gain global experience earlier in their careers. We have a Region Expert program for assistant managers, who take a one-year foreign assignment to do regional research, business analysis, and networking. We have a Field Expert program, which lasts six months to one year and allows selected employees to experience working in an overseas branch and living in a foreign culture. We also try to give our foreign employees more global experience through our Headquarters Global Mobility program, which allows high-performing foreign employees to work at our headquarters in South Korea for up to two years. They observe the business style we use at headquarters and have an opportunity to experience Korean culture.

HBR Reprint R1103D

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Final Assembly Team, Camry Hybrid
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Spotlight

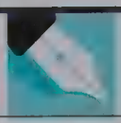


Reinventing Your Personal Brand

How to change your image and create exciting new opportunities *by Dorie Clark*



ARTWORK Leandro Erlich, *Le Cabinet du Psy*, 2005
furnishings (couch, bookshelf, desk, seats), glass, fluorescent lights
Installation at Nogueras Gallery/Blanchard, Barcelona



Dorie Clark (dorie@dorieclark.com) is the CEO of Clark Strategic Communications, a consulting firm that helps clients build their brand reputation and increase sales.

YOU'VE WORKED long and hard, sacrificing to build a solid reputation. When you're out of the room, you know what they're saying: He's an innovative marketer. She's a terrific patent lawyer. He knows everything about the Latvian export market. But what if you now want to rebrand yourself?

People reinvent themselves all the time—to take on a new challenge, shift into more-meaningful work, or rebut perceptions that have hindered their career progress. Sometimes the changes are major (a financial services manager moves into retail, a venture capitalist becomes a life coach). Sometimes the rebranding is subtle, as for an executive who wants to advance but needs to overcome the knock that he's "not good with numbers." Taking control of your personal brand may mean the difference between an unfulfilling job and a rewarding career. As Longfellow noted, "We judge ourselves by what we feel capable of doing, while others judge us by what we have already done." Your path may make perfect sense to you, but how can you persuade others to embrace your new brand—and take you seriously?

These days, I consult on strategy and marketing for *Fortune* 500 companies, major nonprofits, and government agencies. But I have also been a journalist, a political operative, a nonprofit executive director, and a documentary filmmaker—and I studied theology at Harvard along the way. In addition to doing my own rebranding, I've advised scores of executives who were looking for a new direction. I've learned that five steps are key to reinventing yourself for the business marketplace, whether your desired changes are large or small.

1. Define Your Destination

Rebranding isn't easy, and if your plan is poorly thought out, you'll end up confusing yourself and others. Start by determining where you really want to invest your energy. Check out relevant industry trade journals, do informational interviews, even try some internships. (They're not just for college students anymore; VocationVacations, for instance, enables people to apprentice with professionals, ranging from schooner captains to alpaca ranchers to brewmasters.) If you're looking to advance or shift laterally within your company, see if a shadow program or a sabbatical is available—and seek out a mentor who can guide you.

Next you need to build the skills necessary for your new path. If you've been a game developer for the past decade, you may understand the technology better than anyone else in the company. But if you want to move into video game marketing, technical savvy isn't enough; ask yourself what else you need to know—and how to learn it. For Heather, a nonprofit manager who decided to make a new career of her interest in transportation engineering, that meant returning to school for a doctorate and developing her expertise early on as a faculty research assistant. Learning the skills you need will give you the confidence to start publicizing your new identity—and the credibility required to assume it.

2. Leverage Your Points of Difference

What's your unique selling proposition? That's what people will remember, and you can use it to your advantage. After losing popularity to newer, even more right-wing talking heads, the conservative pundit Ann Coulter had to reinvent herself. She didn't entirely abandon her old brand; she reconfigured it to compete in a new marketplace. Leveraging her unique blend of blonde vixen and conservative firebrand, Coulter is now courting gay Republicans who enjoy diva-style smack talk.

As Coulter understood, previous experience can distinctively color your new brand and help you stand out. Heather, the former nonprofit manager, says, "I tried to offer the value-added of having a different perspective." She'd say to her new engineering colleagues, "You know how to build roads. But I worked in the community where you're building the road, and here's how it impacts people." Heather says, "That was my foot in the door."

Finally, use distinguishing characteristics to your advantage, even if they're not strictly relevant to your work. Robert Reich, the former U.S. secretary of labor and my previous employer (I headed up communications when he ran for Massachusetts governor), is under five feet tall. He knew that people seeing him for the first time would be surprised—and he didn't want his height to be a distraction. So he'd loosen up crowds with a joke or two about his stature

and, in the same vein, titled his campaign book *I'll Be Short*. Like it or not, "short" was part of his brand—and he shrewdly leveraged it.

3. Develop a Narrative

You used to write award-winning business columns... and now you want to review restaurants? It's human nature to have many interests, to seek new experiences, and to want to develop new skills. Unfortunately, however, people often view that as the sign of a dilettante. It's unfair, but to protect your personal brand, you need to develop a coherent narrative that explains exactly how your past fits into your present. "I used to write about the business side of many industries, including food and wine," you might say. "I realized that my big-picture knowledge of agricultural trends and business finance uniquely positioned me to cover restaurants with a different perspective." It's like a job interview: You're turning what could be perceived as a weakness ("He doesn't know anything about food, because he's been a business reporter for 20 years") into a compelling strength that people will remember ("He's got a different take on the food industry, because he has knowledge most other people don't").

Successful rebranding doesn't involve inventing a new persona.

The key is not to explain your transition in terms of your own interests ("I was bored with my job and decided to try something else," or "I'm on a personal journey to find the real me") but to focus on the value your prior experience brings. This is particularly relevant for the fresh-out-of-college set, whose early career opportunities have been hobbled by the recession. A stint flipping burgers may not be the ideal résumé builder, but you can get credit for learning valuable skills on the front line of a customer service organization—if you tell your story well.

One caveat is that your narrative must be consistent with your past. Politicians are pilloried for obvious, poll-driven personality changes. (Witness Al Gore's unsuccessful reinvention of himself during the 2000 presidential campaign from eco-wonk to podium-banging "people versus the powerful" crusader for the proletariat.) You, too, will be called out fast if you're seen as abandoning your roots, shading the truth, or not acknowledging your history. It was big news last year when Alex Bogusky, the hipster impresario of Crispin Porter + Bogusky—an ad agency famed for its work on behalf of corporate clients such as Burger King and Coke—left advertising to champion environmental causes and run a center for activists in Boulder, Colorado. His socially conscious rebranding was directly challenged in a *Fast Company* profile that quoted a number of former staffers deriding his purportedly abrasive management style. Successful rebranding doesn't involve inventing a new persona—it's a shift in emphasis that should prompt others to say, "I can see you doing that."

4. Reintroduce Yourself

Once you've embraced your rebrand, making new contacts is the easy part—they'll take the new you at face value. The harder slog is reintroducing yourself to your existing network.

The truth is, the vast majority of people aren't paying much attention to you. That means their perceptions are probably a few years out of date—and it's not their fault. With hundreds (or thousands) of Facebook friends and vague social connections, we can't expect everyone to remember the details of our lives. So we have to strategically reeducate our friends and acquaintances—because they're going to be our buyers, recommenders, or leads for new jobs.

First make sure that all your contact points (Facebook, LinkedIn, personal website, and so forth) are consistent and up-to-date. Jason, an IT contractor from New York City, had a successful business doing hands-on database administration. When he sought to rebrand himself as an IT strategy consultant, he rolled out a new website and e-newsletter to ensure that he was sending clients and colleagues the right message. Don't forget to reach out by phone or e-mail to all the people on your list—individually—to let them know about your new direction and, where appropriate, to ask for help, advice, or business. (Blast e-mails are a start, but they too often go unread.)

In some cases your reintroduction may also involve addressing negative perceptions—and being disciplined about sticking to new behavior that better reflects your aspirations. Before his U.S. Senate victory, Al Franken was known for fiercely partisan political comedy (including his book *Rush Limbaugh Is a Big Fat Idiot*) and theatrics like screaming matches with Bill O'Reilly. But on the campaign trail and in office Franken has used only the gentlest humor, made an effort to forge bipartisan relationships, and focused on serious policy issues, garnering several early legislative successes.

Also think strategically about your "unveiling." Are there projects you can get involved with that will showcase your new interests and abilities (or help you develop them)? Volunteering on political cam-

Idea in Brief

People use career changes to reinvent themselves all the time, but it's important to manage one's brand in such transitions. Doing so can spell the difference between a bungled change and a successful one.

There are five key steps in any personal rebranding:

1. Define your destination and acquire the necessary skills.

2. Craft a unique selling proposition and distinguish yourself by leveraging your points of difference.

3. Develop a narrative that describes your transition in terms of the value it offers others.

4. Reintroduce yourself, using digital media and seizing opportunities to showcase your capabilities.

5. Prove your worth by establishing and promoting your track record.

Traces of your old brand may linger, but a carefully considered strategy and the ability to create unique value in your changed role will help your new brand take hold.

paigns or for charitable causes is one high-profile way to make new contacts and develop new skills. Leveraging opportunities within your company is another. If a major new initiative is launching, try to jump on board. If competition is too fierce, you can take on jobs that others don't want (such as administrative duties) but that will help you meet people and build crucial connections.

5. Prove Your Worth

Every art student has a portfolio ready to be shown at a moment's notice. It's no different in the business world. There's a wide gulf between my knowing that you've launched a new business and trusting that you'll do a good job for clients. I may like you a lot, but unless I see proof of your skills, I'll hesitate to put my own reputation on the line by sending you referrals.

That's where blogs, podcasts, videocasts, and other forms of social media come in. The first step is securing your own internet domain name and starting to produce unique intellectual property. The second, even more critical, is ensuring that your material offers real value. You can quickly establish your expertise if you help people solve a problem or do something better, as was the case with Brian Clark (no relation), a former attorney who founded the website Copyblogger and has built a huge following with frequent tip-laden posts on how to improve web content and gain online followers.

Sharing the content you've created allows potential customers or employers to test-drive your approach before making a large commitment. (If you're a graphic designer, having contacts check out an image gallery of corporate logos you've created may inspire one of them to send you that major new account.)

After you've demonstrated your ability, solidify your rebrand by associating with the leading organizations in your field. Make a focused effort to publish in respected journals, speak at industry conferences, or take on a leadership role in your trade association. The resulting visibility, connections, and credibility can pay major dividends. When the Rhode Island consultant Alan Weiss took on the presidency of the National Speakers Association, New England, in the mid-1990s, the high-profile position not only brought him new business (he traces $250,000 in earnings directly to it) but helped him broaden his reputation and launch new offerings (he subsequently wrote two books on professional speaking and now provides high-end training).

Finally, you have to be consistent and committed as you move forward. A desire to expand into international work won't go far if you don't make the effort to learn new languages or the nuances of other cultures. And a onetime charitable gift is nice but quickly forgotten. The key is long-term effort. Michael Milken—once best known as a 1980s high-flier jailed for securities violations—dramatically redeemed his reputation through more than three decades of committed philanthropy. He has raised hundreds of millions of dollars to combat prostate cancer, melanoma, epilepsy, and more, earning a 2004 *Fortune* cover story (and mega-rebrand) titled "The Man Who Changed Medicine."

Especially in the internet era, traces of your old brand will never completely disappear—and as long as you're thoughtful about what you've learned along the way, that's OK. The challenge is to be strategic about identifying how you wish to be perceived, developing a compelling story that explains your evolution, and then spreading that message. Consider it "search engine optimization" for your life: The more connections you make, and the more value and content you regularly add to the stream, the more likely it is that your new brand will be known, recognized, and sought out.

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Making Resource Management Work: Sustainability and the Supply Chain



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Why should the supply chain be a focal point for a company's sustainability plan?

For most large companies, the supply chain, across all tiers, creates the largest "environmental footprint" related to the effective management of raw materials, energy, water, and waste. A supply chain is to a company what an ecosystem is to a species. You cannot understand the sustainability of a company without understanding the sustainability of the systems that support it – with financial capital, human capital, and natural capital. Hitachi, Ltd., has concluded the same, which is why we are an active member in the United Nations Global Compact Advisory Group on Supply Chain Sustainability.

Why is resource management the best starting point in a sustainable supply chain effort?

Resource management as a starting point is imperative because of the predicted significant rise in human population and decline in available natural resources over the next 40 years. Approximately 6.7 billion people now live on this planet, and the global population is expected to reach more than 9 billion by 2050. At the same time, the human footprint – our use of natural resources for everything we grow, eat, drink, make, package, buy, transport, and discard – is outpacing the earth's capacity to sustain us.

The supply chain function and discipline is at its essence both a resource management challenge and opportunity. Well-run companies today already have a good understanding of the conventional aspects of their supply chains for components and feed stocks. What is not yet so well understood is the shared exposure to changing risks and opportunities around the cost and availability of underlying basic resources such as energy. The supply chain relationship will become more adaptable and sustainable as the risks and opportunities under different scenarios become actionable. Establishing a common information platform to enable the integration of resource flow models across the enterprises is what makes this possible.

How do you get vendors and partners involved to make a real impact?

You make it easy by adopting a common platform for capturing, analyzing, and sharing information. The fragmentation of data within and between interdependent organizations is overcome by establishing a robust, dynamic, calibrated model of both the financial flows and the underlying material resource flows that link companies and customers together. An interesting company we work with, C3, offers exciting and innovative software solutions in this area. Supply chain partner involvement must be collaboratively defined and executed across major phases, including goal setting, process definition, measurement, transparent reporting, and performance-based business outcomes.

How does a sustainable supply chain become a competitive advantage?

When a company reaches a point in its sustainable supply chain initiative where lower costs, less resource supply volatility, increased demand for forecasting accuracy, less regulatory exposure, and increased innovation connectivity to consumer demands are a part of everyday operations, it will have achieved competitive advantage in the marketplace. Employee morale, recruiting effectiveness, customer loyalty, and shareholder value are all positively impacted when these achievements are transparently communicated to all stakeholders.

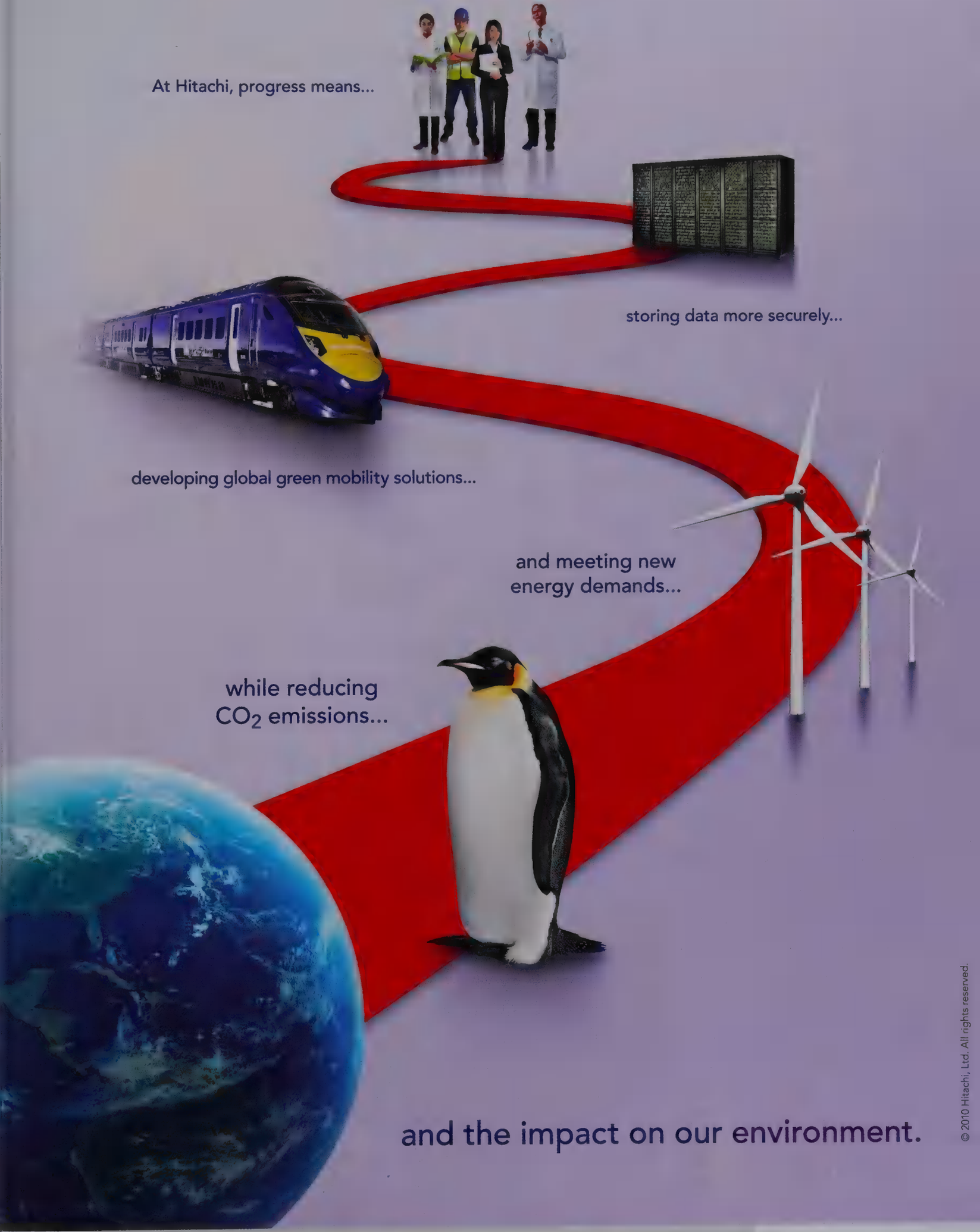
How do consumers become a part of the sustainable supply chain?

Whether purchasing locally grown organic produce, driving hybrid or electric vehicles, switching power generation sources to clean renewables with their utilities, or refusing to purchase electronics without a clear recycling program, consumers are increasingly impacting the sustainable supply chain. Consumers across the globe are becoming more informed, influential, and discriminating in their approach to purchasing sustainable products and services.

Sophisticated consumers will eschew simplistic product labels and scorecards, recognizing that the pursuit of sustainability is complex and dynamic. These consumers recognize and reward companies that take the long view and adopt systemic approaches to optimizing the resource efficiency of goods and services across their entire life cycles – not just offering "green" product lines or executing stand-alone efficiency projects.

Consumers who truly want to invest themselves in making supply chains more sustainable will want to become integrated with supply chains that adopt model-based, ecosystem approaches that dynamically and transparently connect and calibrate strategic decisions around capital deployment, product mix, and asset utilization with a clear understanding of the underlying energy and natural resource flows through interconnected enterprises.

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Dominic Barton is the global managing director of McKinsey & Company.

Capitalism for the Long Term

Business leaders face a choice: They can reform the system, or watch as the government exerts control. A call to action from McKinsey & Company's global managing director *by Dominic Barton*

The near meltdown of the financial system and the ensuing Great Recession have been, and will remain, the defining issue for the current generation of executives. Now that the worst seems to be behind us, it's tempting to feel deep relief—and a strong desire to return to the comfort of business as usual. But that is simply not an option. In the past three years we've already seen a dramatic acceleration in the shifting balance of power between the developed West and the emerging East, a rise in populist politics and social stresses in a number of countries, and significant strains on global governance systems. As the fallout from the crisis continues, we're likely to see increased geopolitical rivalries, new international security challenges, and rising tensions from trade, migration, and resource competition. For business leaders, however, the most consequential outcome of the crisis is the challenge to capitalism itself.

That challenge did not just arise in the wake of the Great Recession. Recall that trust in business hit historically low levels more than a decade ago. But the crisis and the surge in public antagonism it unleashed have exacerbated the friction between business and society. On top of anxiety about persistent problems such as rising income inequality, we now confront understandable anger over high unemployment, spiraling budget deficits, and a host of other issues. Governments feel pressure to reach ever deeper inside businesses to exert control and prevent another system-shattering event.

My goal here is not to offer yet another assessment of the actions policymakers have taken or will take as they try to help restart global growth. The audience I want to engage is my fellow business leaders. After all, much of what went awry before and after the crisis stemmed from failures of governance, decision making, and leadership within companies. These are failures we can and should address ourselves.

In an ongoing effort that started 18 months ago, I've met with more than 400 business and government leaders across the globe. Those conversations have reinforced my strong sense that, despite a certain amount of frustration on each side, the two groups share the belief that capitalism has been and can continue to be the greatest engine of prosperity ever devised—and that we will need it to be at the top of its job-creating, wealth-generating game in the years to come. At the same time, there is growing concern that if the fundamental issues revealed in the crisis remain unaddressed and the system fails again, the social contract between the capitalist system and the citizenry may truly rupture, with unpredictable but severely damaging results.

Most important, the dialogue has clarified for me the nature of the deep reform that I believe business must lead—nothing less than a shift from what I call quarterly capitalism to what might be referred to as long-term capitalism. (For a rough definition of "long term," think of the time required to invest in and build a profitable new business, which McKinsey research suggests is at least five to seven years.) This shift is not just about persistently thinking and acting with a next-generation view—although that's a key part of it. It's about rewiring the fundamental ways we govern, manage, and lead corporations. It's also about changing how we view business's value and its role in society.

There are three essential elements of the shift. First, business and finance must jettison their short-term orientation and revamp incentives and structures in order to focus their organizations on the long term. Second, executives must infuse their organizations with the perspective that serving the interests of all major stakeholders—employees, suppliers, customers, creditors, communities, the environment—is not at odds with the goal of maximizing corporate value; on the contrary, it's essential to achieving that goal. Third, public companies must cure the ills stemming from dispersed and disengaged ownership by bolstering boards' ability to govern like owners.

None of these ideas, or the specific proposals that follow, are new. What *is* new is the urgency of the challenge. Business leaders today face a choice: We can reform capitalism, or we can let capitalism be reformed for us, through political measures and the pressures of an angry public. The good news is that the reforms will not only increase trust in the system; they will also strengthen the system itself. They will unleash the innovation needed to tackle the world's grand challenges, pave the way for a new era of shared prosperity, and restore public faith in business.

1 Fight the Tyranny of Short-Termism

As a Canadian who for 25 years has counseled business, public sector, and nonprofit leaders across the globe (I've lived in Toronto, Sydney, Seoul, Shanghai, and now London), I've had a privileged glimpse into different societies' values and how leaders in various cultures think. In my view, the most striking difference between East and West is the time frame leaders consider when making major decisions. Asians typically think in terms of at least 10 to 15 years. For example, in my discussions with the South Korean president Lee Myung-bak shortly after his election in 2008, he asked us to help come up with a 60-year view of his country's future (though we settled for producing a study called *National Vision 2020*.) In the U.S. and Europe, nearsightedness is the norm. I believe that having a long-term perspective is *the* competitive advantage of many Asian economies and businesses today.

Myopia plagues Western institutions in every sector. In business, the mania over quarterly earnings consumes extraordinary amounts of senior time and attention. Average CEO tenure has dropped from 10 to six years since 1995, even as the complexity and scale of firms have grown. In politics, democracies lurch from election to election, with candidates proffering dubious short-term panaceas while letting long-term woes in areas such as economic competitiveness, health, and education fester. Even phi-

When making major decisions, Asians typically think in terms of at least 10 to 15 years. In the U.S. and Europe, nearsightedness is the norm.

Idea in Brief

The financial and economic crisis may have eased, but the foundations of capitalism are still shaky. Governments feel pressured to involve themselves ever more deeply in the affairs of business so that another system-shattering event doesn't occur. Rising income inequality, high unemployment, and spiraling budget deficits are exacerbating public antagonism toward business. And the shifting balance of power between East and West promises to feed the tensions.

But perhaps the biggest danger to capitalism is that short-term approaches to running and investing in companies—the "quarterly capitalism" responsible for the near-meltdown of the financial system—still reign.

Business leaders have a choice: They can take the initiative to reform the system, or the system will be reformed for them. In particular, there are three concrete steps they should consider: jettisoning their organization's short-term orientation and changing its structure and incentives to focus on the long term; infusing their organizations with the perspective that serving the interests of all major stakeholders is not at odds with the goal of maximizing corporate value; and bolstering boards' ability to govern like owners.

These steps will not only make the capitalist system stronger and more trusted; they will also spur innovation and fuel sustainable economic growth.

lanthropy often exhibits a fetish for the short term and the new, with grantees expected to become self-sustaining in just a few years.

Lost in the frenzy is the notion that long-term thinking is essential for long-term success. Consider Toyota, whose journey to world-class manufacturing excellence was years in the making. Throughout the 1950s and 1960s it endured low to nonexistent sales in the U.S.—and it even stopped exporting altogether for one bleak four-year period—before finally emerging in the following decades as a global leader. Think of Hyundai, which experienced quality problems in the late 1990s but made a comeback by reengineering its cars for long-term value—a strategy exemplified by its unprecedented introduction, in 1999, of a 10-year car warranty. That radical move, viewed by some observers as a formula for disaster, helped Hyundai quadruple U.S. sales in three years and paved the way for its surprising entry into the luxury market.

To be sure, long-term perspectives can be found in the West as well. For example, in 1985, in the face of fierce Japanese competition, Intel famously decided to abandon its core business, memory chips, and focus on the then-emerging business of microprocessors. This "wrenching" decision was "nearly inconceivable" at the time, says Andy Grove, who was then the company's president. Yet by making it, Intel emerged in a few years on top of a new multibillion-dollar industry. Apple represents another case in point. The iPod, released in 2001, sold just 400,000 units in its first year, during which Apple's share price fell by roughly 25%. But the board took the long view. By late 2009 the company had sold 220 million iPods—and revolutionized the music business.

It's fair to say, however, that such stories are countercultural. In the 1970s the average holding period for U.S. equities was about seven years; now it's more like seven months. According to a recent paper by Andrew Haldane, of the Bank of England, such churning has made markets far more volatile and produced yawning gaps between corporations' market price and their actual value. Then there are the "hyperspeed" traders (some of whom hold stocks for only a few seconds), who now account for 70% of all U.S. equities trading, by one estimate. In response to these trends, executives must do a better job of filtering input, and should give more weight to the views of investors with a longer-term, buy-and-hold orientation.

If they don't, short-term capital will beget short-term management through a natural chain of incentives and influence. If CEOs miss their quarterly earnings targets, some big investors agitate for their removal. As a result, CEOs and their top teams work overtime to meet those targets. The unintended upshot is that they manage for only a small portion of their firm's value. When McKinsey's finance experts deconstruct the value expectations embedded in share prices, we typically find that 70% to 90% of a company's value is related to cash flows expected three or more years out. If the vast majority of most firms' value depends on results more than three years from now, but management is preoccupied with what's reportable three months from now, then capitalism has a problem.

Some rightly resist playing this game. Unilever, Coca-Cola, and Ford, to name just a few, have stopped issuing earnings guidance altogether. Google never did. IBM has created five-year road maps to encourage investors to focus more on whether it will reach its long-term earnings targets than on whether it exceeds or misses this quarter's target by a few pennies. "I can easily make my numbers by cutting SG&A or R&D, but then we wouldn't get the innovations we need," IBM's CEO, Sam Palmisano, told us recently. Mark Wiseman, executive vice president at the

70%

Roughly 70% of all U.S. equities trading is now done by "hyperspeed" traders—some of whom hold stocks for only a few seconds.

Who's Getting It Right?

Environmental, social, and governance initiatives can serve a wide range of stakeholders *and* benefit shareholders. Companies can:

Create new products and markets

Three years ago **Verizon** developed a phone and a calling plan to address the needs of seniors and the disabled. It sold 400,000 of the new phones and doubled senior customers' wireless spending.

Drive operational efficiency

During the past several years **Walmart** has been working to establish tough new targets for reducing suppliers' packaging waste. Its goal—to trim packaging by 5% between 2008 and 2013—should generate $12 billion in savings across its global supply chain.

Canada Pension Plan Investment Board, advocates investing "for the next quarter century," not the next quarter. And Warren Buffett has quipped that his ideal holding period is "forever." Still, these remain admirable exceptions.

To break free of the tyranny of short-termism, we must start with those who provide capital. Taken together, pension funds, insurance companies, mutual funds, and sovereign wealth funds hold $65 trillion, or roughly 35% of the world's financial assets. If these players focus too much attention on the short term, capitalism as a whole will, too.

In theory they shouldn't, because the beneficiaries of these funds have an obvious interest in long-term value creation. But although today's standard practices arose from the desire to have a defensible, measurable approach to portfolio management, they have ended up encouraging shortsightedness. Fund trustees, often advised by investment consultants, assess their money managers' performance relative to benchmark indices and offer only short-term contracts. Those managers' compensation is linked to the amount of assets they manage, which typically rises when short-term performance is strong. Not surprisingly, then, money managers focus on such performance—and pass this emphasis along to the companies in which they invest. And so it goes, on down the line.

As the stewardship advocate Simon Wong points out, under the current system pension funds deem an asset manager who returns 10% to have underperformed if the relevant benchmark index rises by 12%. Would it be unthinkable for institutional investors instead to live with absolute gains on the (perfectly healthy) order of 10%—especially if they like the approach that delivered those gains—and review performance every three or five years, instead of dropping the 10-percenter? Might these big funds set targets for the number of holdings and rates of turnover, at least within the "fundamental investing" portion of their portfolios, and more aggressively monitor those targets? More radically, might they end the practice of holding thousands of stocks and achieve the benefits of diversification with fewer than a hundred—thereby increasing their capacity to effectively engage with the businesses they own and improve long-term performance? Finally, could institutional investors beef up their internal skills and staff to better execute such an agenda? These are the kinds of questions we need to address if we want to align capital's interests more closely with capitalism's.

45%

Only 45% of those surveyed in the U.S. and the UK expressed trust in business. This stands in stark contrast to developing countries: For example, the figure is 61% in China, 70% in India, and 81% in Brazil.

2 Serve Stakeholders, Enrich Shareholders

The second imperative for renewing capitalism is disseminating the idea that serving stakeholders is essential to maximizing corporate value. Too often these aims are presented as being in tension: You're either a champion of shareholder value or you're a fan of the stakeholders. This is a false choice.

The inspiration for shareholder-value maximization, an idea that took hold in the 1970s and 1980s, was reasonable: Without some overarching financial goal with which to guide and gauge a firm's performance, critics feared, managers could divert corporate resources to serve their own interests rather than the owners'. In fact, in the absence of concrete targets, management might become an exercise in politics and stakeholder engagement an excuse for inefficiency. Although this thinking was quickly caricatured in popular culture as the doctrine of "greed is good," and was further tarnished by some companies' destructive practices in its name, in truth there was never any inherent tension between creating value and serving the interests of employees, suppliers, customers, creditors, communities, and

Motivate and retain employees

Novo Nordisk's mission to end diabetes would, if accomplished, put the company out of business. Yet the firm has an enormously committed workforce, not least in developing countries and especially in China, where its initiatives (such as the first Chinese-language website for people with diabetes) have helped it gain a 70% market share.

Spur innovation

GE's "bottom of the pyramid" development of low-cost medical imaging for the Indian and Chinese markets led to efficiency breakthroughs in design and engineering and to new products that now account for growing sales in advanced nations as well. (See "How GE Is Disrupting Itself," HBR October 2009.)

Retain access to inputs

Coca-Cola has devised a sophisticated global water strategy that ensures that local concerns as well as local supply and demand issues are integrated into the long-range plans for each plant. This approach helps avoid both public backlashes over water use and operational problems due to water shortages.

the environment. Indeed, thoughtful advocates of value maximization have always insisted that it is *long-term* value that has to be maximized.

Capitalism's founding philosopher voiced an even bolder aspiration. "All the members of human society stand in need of each others assistance, and are likewise exposed to mutual injuries," Adam Smith wrote in his 1759 work, *The Theory of Moral Sentiments*. "The wise and virtuous man," he added, "is at all times willing that his own private interest should be sacrificed to the public interest," should circumstances so demand.

Smith's insight into the profound interdependence between business and society, and how that interdependence relates to long-term value creation, still reverberates. In 2008 and again in 2010, McKinsey surveyed nearly 2,000 executives and investors; more than 75% said that environmental, social, and governance (ESG) initiatives create corporate value in the long term. Companies that bring a real stakeholder perspective into corporate strategy can generate tangible value even sooner. (See the sidebar "Who's Getting It Right?")

Creating direct business value, however, is not the only or even the strongest argument for taking a societal perspective. Capitalism depends on public trust for its legitimacy and its very survival. According to the Edelman public relations agency's just-released 2011 Trust Barometer, trust in business in the U.S. and the UK (although up from mid-crisis record lows) is only in the vicinity of 45%. This stands in stark contrast to developing countries: For example, the figure is 61% in China, 70% in India, and 81% in Brazil. The picture is equally bleak for individual corporations in the Anglo-American world, "which saw their trust rankings drop again last year to near-crisis lows," says Richard Edelman.

How can business leaders restore the public's trust? Many Western executives find that nothing in their careers has prepared them for this new challenge. Lee Scott, Walmart's former CEO, has been refreshingly candid about arriving in the top job with a serious blind spot. He was plenty busy minding the store, he says, and had little feel for the need to engage as a statesman with groups that expected something more from the world's largest company. Fortunately, Scott was a fast learner, and Walmart has become a leader in environmental and health care issues.

Tomorrow's CEOs will have to be, in Joseph Nye's apt phrase, "tri-sector athletes": able and experienced in business, government, and the social sector. But the pervading mind-set gets in the way of building those leadership and management muscles. "Analysts and investors are focused on the short term," one executive told me recently. "They believe social initiatives don't create value in the near term." In other words, although a large majority of executives believe that social initiatives create value in the long term, they don't act on this belief, out of fear that financial markets might frown. Getting capital more aligned with capitalism should help businesses enrich shareholders by better serving stakeholders.

3 Act Like You Own the Place

As the financial sector's troubles vividly exposed, when ownership is broadly fragmented, no one acts like he's in charge. Boards, as they currently operate, don't begin to serve as a sufficient proxy. *All the Devils Are Here*, by Bethany McLean and Joe Nocera, describes how little awareness Merrill Lynch's board had of the firm's soaring exposure to subprime mortgage instruments until it was too late. "I actually don't think risk management failed," Larry Fink, the CEO of the investment firm BlackRock, said during a 2009 debate about the future of capitalism, sponsored by the *Financial Times*.



"I think corporate governance failed, because...the boards didn't ask the right questions."

What McKinsey has learned from studying successful family-owned companies suggests a way forward: The most effective ownership structure tends to combine some exposure in the public markets (for the discipline and capital access that exposure helps provide) with a significant, committed, long-term owner. Most large public companies, however, have extremely dispersed ownership, and boards rarely perform the single-owner-proxy role. As a result, CEOs too often listen to the investors (and members of the media) who make the most noise. Unfortunately, those parties tend to be the most nearsighted ones. And so the tyranny of the short term is reinforced.

The answer is to renew corporate governance by rooting it in committed owners and by giving those owners effective mechanisms with which to influence management. We call this *ownership-based governance,* and it requires three things:

More-effective boards. In the absence of a dominant shareholder (and many times when there is one), the board must represent a firm's owners and serve as the agent of long-term value creation. Even among family firms, the executives of the top-performing companies wield their influence through the board. But only 43% of the nonexecutive directors of public companies believe they significantly influence strategy. For this to change, board members must devote much more time to their roles. A government-commissioned review of the governance of British banks last year recommended an enormous increase in the time required of nonexecutive directors of banks—from the current average, between 12 and 20 days annually, to between 30 and 36 days annually. What's especially needed is an increase in the informal time board members spend with investors and executives. The nonexecutive board directors of companies owned by private equity firms spend 54 days a year, on average, attending to the company's business, and 70% of that time consists of informal meetings and conversations. Four to five days a month obviously give a board member much greater understanding and impact than the three days a quarter (of which two may be spent in transit) devoted by the typical board member of a public company.

43%

Just 43% of the nonexecutive directors of public companies believe they significantly influence strategy. For this to change, board members must devote much more time to their roles.

Boards also need much more relevant experience. Industry knowledge—which four of five nonexecutive directors of big companies lack—helps boards identify immediate opportunities and reduce risk. Contextual knowledge about the development path of an industry—for example, whether the industry is facing consolidation, disruption from new technologies, or increased regulation—is highly valuable, too. Such insight is often obtained from experience with other industries that have undergone a similar evolution.

In addition, boards need more-effective committee structures—obtainable through, for example, the establishment of a strategy committee or of dedicated committees for large business units. Directors also need the resources to allow them to form independent views on strategy, risk, and performance (perhaps by having a small analytical staff that reports only to them). This agenda implies a certain professionalization of nonexecutive directorships and a more meaningful strategic partnership between boards and top management. It may not please some executive teams accustomed to boards they can easily "manage." But given the failures of governance to date, it is a necessary change.

More-sensible CEO pay. An important task of governance is setting executive compensation. Although 70% of board directors say that pay should be tied more closely to performance, CEO pay is too often structured to reward a leader simply for having

Companies should create real risk for executives. Some experts privately suggest mandating that new executives invest a year's salary in the company.

made it to the top, not for what he or she does once there. Meanwhile, polls show that the disconnect between pay and performance is contributing to the decline in public esteem for business.

CEOs and other executives should be paid to act like owners. Once upon a time we thought that stock options would achieve this result, but stock-option-based compensation schemes have largely incentivized the wrong behavior. When short-dated, options lead to a focus on meeting quarterly earnings estimates; even when long-dated (those that vest after three years or more), they can reward managers for simply surfing industry- or economy-wide trends (although reviewing performance against an appropriate peer index can help minimize free rides). Moreover, few compensation schemes carry consequences for failure—something that became clear during the financial crisis, when many of the leaders of failed institutions retired as wealthy people.

There will never be a one-size-fits-all solution to this complex issue, but companies should push for change in three key areas:

- They should link compensation to the fundamental drivers of long-term value, such as innovation and efficiency, not just to share price.
- They should extend the time frame for executive evaluations—for example, using rolling three-year performance evaluations, or requiring five-year plans and tracking performance relative to plan. This would, of course, require an effective board that is engaged in strategy formation.
- They should create real downside risk for executives, perhaps by requiring them to put some skin in the game. Some experts we've surveyed have privately suggested mandating that new executives invest a year's salary in the company.

Redefined shareholder "democracy." The huge increase in equity churn in recent decades has spawned an anomaly of governance: At any annual meeting, a large number of those voting may soon no longer be shareholders. The advent of high-frequency trading will only worsen this trend. High churn rates, short holding periods, and vote-buying practices may mean the demise of the "one share, one vote" principle of governance, at least in some circumstances. Indeed, many large, top-performing companies, such as Google, have never adhered to it. Maybe it's time for new rules that would give greater weight to long-term owners, like the rule in some French companies that gives two votes to shares held longer than a year. Or maybe it would make sense to assign voting rights based on the average turnover of an investor's portfolio. If we want capitalism to focus on the long term, updating our notions of shareholder democracy in such ways will soon seem less like heresy and more like common sense.

WHILE I remain convinced that capitalism is the economic system best suited to advancing the human condition, I'm equally persuaded that it must be renewed, both to deal with the stresses and volatility ahead and to restore business's standing as a force for good, worthy of the public's trust. The deficiencies of the quarterly capitalism of the past few decades were not deficiencies in capitalism itself—just in that particular variant. By rebuilding capitalism for the long term, we can make it stronger, more resilient, more equitable, and better able to deliver the sustainable growth the world needs. The three imperatives outlined above can be a start along this path and, I hope, a way to launch the conversation; others will have their own ideas to add.

The kind of deep-seated, systemic changes I'm calling for can be achieved only if boards, business executives, and investors around the world take responsibility for bettering the system they lead. Such changes will not be easy; they are bound to encounter resistance, and business leaders today have more than enough to do just to keep their companies running well. We must make the effort regardless. If capitalism emerges from the crisis vibrant and renewed, future generations will thank us. But if we merely paper over the cracks and return to our precrisis views, we will not want to read what the historians of the future will write. The time to reflect—and to act—is now.

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EBay CEO John Donahoe



How eBay Developed A Culture of Experimentation

JOHN DONAHOE HAD BIG SHOES TO FILL in 2008 when he took over from Meg Whitman, eBay's celebrated longtime CEO. He also had work to do. The company's core business was slipping, and a major acquisition, Skype, had gone wrong. In this edited interview with HBR's Adi Ignatius, Donahoe talks about reinvention, experimentation, and whether any CEO is worth the $10 million he made last year.

HBR: EBay changed how the world does business. But it's been around now for 15 years. How do you avoid the slowed growth that usually comes with age?

Donahoe: Yes, we're 15 years old, but in each five-year phase of the internet there have been significant differences in the key driving forces and the companies leading them. And there will be more change in the next five years than there's been in the past 10. We're very focused on capitalizing on this period of dynamic change in how consumers behave.

But in some ways eBay is still in its original incarnation, and it's now almost a traditional merchant. Do you ever feel you're missing innovation opportunities?

Well, no. One of the most fundamental forces changing how we operate is the smartphone. We launched our iPhone application in 2009. In its first year it did more than $600 million in volume. In 2010 it did between $1.5 billion and $2 billion. More than 14 million people have downloaded eBay's iPhone application—it's by far the largest m-commerce application

My job is not to try to be like Meg Whitman. I never could be—plus I never want to run for governor.

in the world. Mobile is bringing the internet to you seven days a week, 24 hours a day, on your time, at your convenience, where you want to be. We're finding out how people shop now: They're standing in a line at Starbucks, let's say, and they start browsing on eBay. They see something they want and they buy it right there.

Mobile also seems to be breaking down the barriers between online and offline.

We bought this little mobile company called RedLaser. You take your smartphone camera, you look at an item, you scan the UPC, and it tells you what the item is selling for on eBay, on Walmart.com, on BestBuy.com, all across the web. You can immediately price compare or get additional information. And we just bought a company called Milo, which brings up inventory in local stores online. We integrated that into RedLaser, so if you're in Boston and you want to buy a pair of Nikes, you walk into the nearest shoe store, you scan the shoe you want, and you can see its price at other merchants within five or 10 miles of you.

Everyone says they want to be where the customer is, but at a certain point you have to make some bets. Are tablets like the iPad where your business is going?

What we're finding is that consumers are using multiple devices—iPhone, iPad, laptop, in some cases a desktop at home with a big monitor. A subset of our mobile volume is people who did research on a laptop or a desktop at night. They found an item and put it into My eBay, which is a place where you can watch your items, and the next day they bought it on an iPhone.

Mobile users are four times as engaged as nonusers, but not just on their mobile devices. Within a year you're going to be able to walk into your house while using your iPhone and have that connection seamlessly transferred to your laptop or your TV—they're all just devices that connect to the internet. The internet will be much more present in your life, but on your terms.

Are you trying to create a bigger platform for innovation that some of the newer social shopping companies could join and develop?

Absolutely. The eBay platform already has more than 119,000 developers, and 25% of the listings on eBay come through third-party applications that developers have built. Last year PayPal became the first payment system in history to open up its platform. This transitions us—eBay and PayPal—from having to create all the innovation to enabling some of it.

Given PayPal's growth, are you gradually becoming more a PayPal company than an eBay company?

We're a consumer company. Our core mission is to connect buyers and sellers, and eBay, StubHub, and PayPal are all ways to do that.

You've been in the top job for almost three years, yet it's fair to say that some still regard your predecessor, Meg Whitman, as the face of the company. What are the advantages and burdens of following a high-profile CEO like her?

Meg helped build eBay into what it is and did a phenomenal job, and I stand on the shoulders of what she created. But my job is not to try to be like Meg Whitman. I never could be—plus I never want to run for governor. I'll go on record: I never want to run for governor.

Be careful what you promise.

It's my job to take this incredible company and the core values that Pierre Omidyar, our founder, created in the business that Meg and that first-generation team helped build, and ensure that we're positioned to succeed in today's and tomorrow's world. The level of change in consumer behavior is enormous, but we bring to it a great set of core values and a strong business.

The core auction business had faltered somewhat in the years before you took over as CEO. Tell us about your efforts to revive it.

Well, auctions provide price transparency and help items of uncertain value establish a market price.

With the emergence of product search on the internet, that role is no longer needed, so a lot of the changes I've made over the past couple of years have been to make our marketplace indifferent to format. If a buyer and a seller want to transact in a fixed-price format, they can. If they want to transact in an auction format, they can. A couple of years ago we saw fixed-price sales surpass auctions for the first time; I expect the ratio to settle at about 70% fixed price and 30% auction. But that will require a complete re-architecting of almost every element of the business system: pricing, incentive and feedback policies, search algorithms, seller tools and onloading.

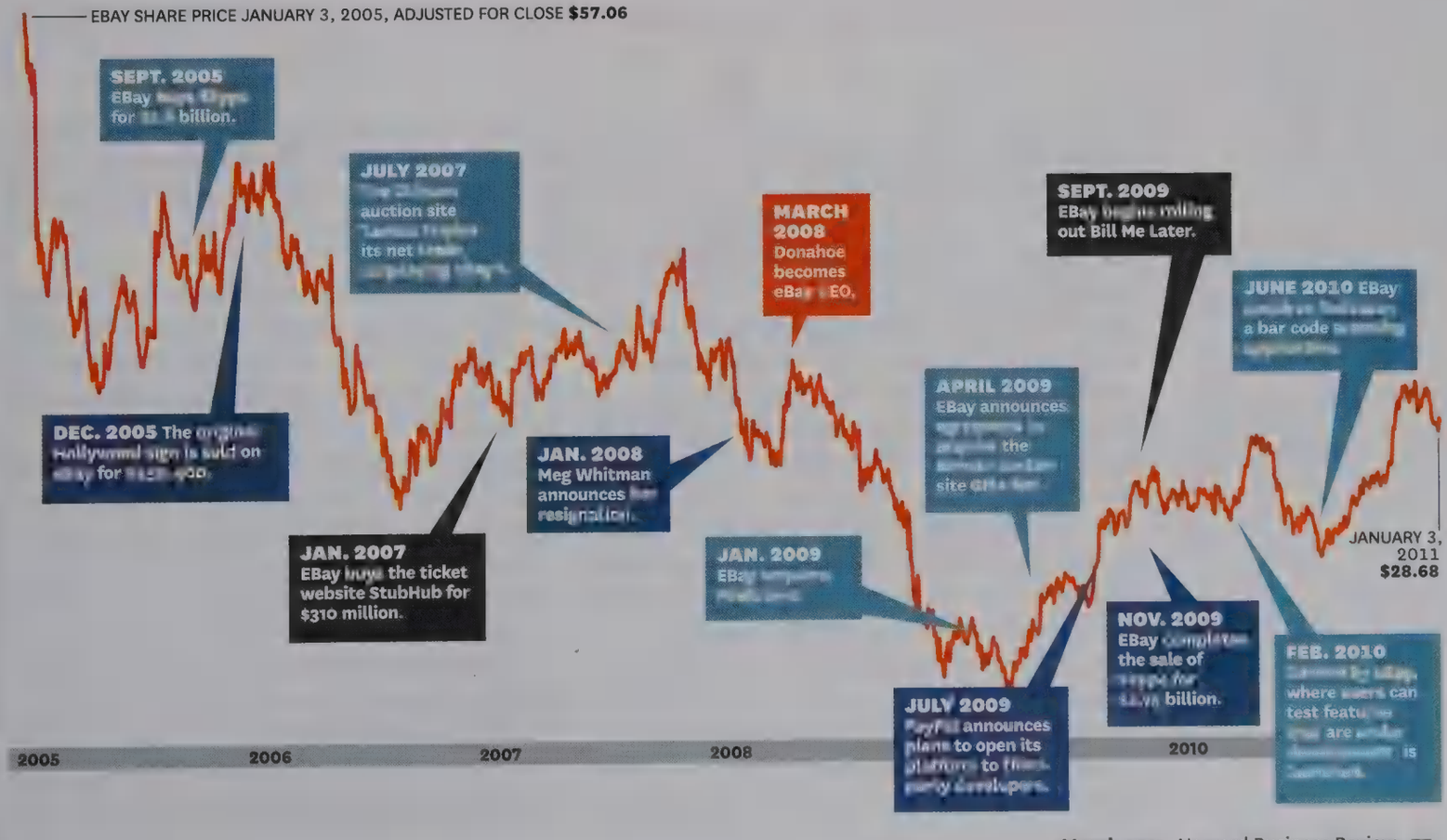
You've created Garden by eBay to try some experiments. What are you learning?

Two of the major themes of my time as CEO have been a greater focus on customers and a greater focus on driving innovation. The Garden offers a chance for our engineers to get real customer feedback on innovations. For instance, if you shop for an iPad or an iPhone, you can see auctions and fixed-price sales in a side-by-side format and make a decision right there: Do I want to engage in the auction? We tested it. We got customer feedback. We refined it.

Let's talk about some of the acquisitions eBay has made. What happened with Skype, and why didn't that pan out?

Skype was acquired by eBay under Meg's leadership in 2005. At the time, we thought Skype might be another way to connect buyers and sellers. But that didn't turn out to be the case. Skype is an enormously successful way to connect people, but not through commerce. When I became CEO, I felt it was really important to focus—that you can't compete and succeed on multiple fronts. Skype was a fantastic business, but it didn't have synergy with eBay and PayPal, so I made the decision early in my tenure to divest it, and we sold 70%.

Judging the Donahoe Era



With your other acquisitions, what have you learned about how to make them work, how to integrate them into the culture?

We think about acquisitions in three categories: acquisitions to strengthen our core, adjacent acquisitions, and capability acquisitions. The easiest are the first kind, like the acquisition two years ago of [the Korean auction site] Gmarket. We're letting adjacent acquisitions, such as StubHub and Bill Me Later, run relatively independently. With Bill Me Later we've integrated core capabilities into PayPal and eBay. Positronic, a small search company, is in the third category. In many cases we're buying the people—Christopher Payne, who's running eBay North America now, was a founder of Positronic—which helps us integrate faster and acquire great talent.

So what's your biggest challenge now: execution or innovation?

I think it's the intersection of the two. We have to keep innovating, but we have to execute at scale, and the challenge is how to balance the pace of change in the eyes of the consumer. Existing users often don't like the changes initially, because they're used to a certain way of shopping, yet new users do like them.

How do you cultivate and sustain risk-taking as the company expands?

By talking about it. By celebrating failure—cases where we took bold risks and things didn't work out exactly as we imagined, but we recognized that and made adjustments. In 2010 we introduced the largest pricing change in eBay's history in the U.S., to make our marketplace truly balanced between auctions and fixed price. Six or eight weeks in, I knew something wasn't right. There was a second-order dynamic in the marketplace that was depressing it, so over the summer we really drilled down to understand what was going on. That was a period of anxiety, but I had no regrets. It was one of those changes where you either flip the switch and go for it or you don't do it. We diagnosed the issues, we made adjustments, and we benefited in the fourth quarter. That's a lot of what business is today: the old "Ready, fire, aim." You're better off moving and, if you don't get it exactly right, making an adjustment. That's the only way to compete on the internet today, because it's moving so fast.

What about China? The general perception is that Alibaba and its Taobao.com auction site ate eBay's lunch some years back. What's your China strategy now?

Well, there are two parts to China. One is the domestic market, and the reality is that for all major internet categories it is dominated by Chinese companies. That's because you have great entrepreneurs like Jack Ma, of Alibaba; Robin Li, of Baidu; and Pony Ma, of Tencent. But it's also because the playing field there is not necessarily level, so whether it's eBay or Google or Facebook, a major global internet company doesn't really have much traction in domestic China. I think that will change over time, but we respect and understand it, so we've in essence gone the joint-venture route.

The second part is an enormous cross-border business that connects Chinese sellers with buyers all over the world. In fact, it accounts for $4 billion annually in trades on eBay and PayPal.

As a guy with an MBA who worked for Bain for many years, what do you think about investors' focusing short term on share price rather than long term on development? Would you like to see a shift in investor values?

The thing that was drilled into me at Bain was that in consulting you had to be incredibly customer focused, because you had no product other than yourself. I bring that to eBay. If there's one mark of my tenure at eBay, it's making us a more customer-focused company. So "short term" and "long term" can be confusing. If you're really focusing on what you have to do to serve the customer's needs today and in the future, some of those distinctions fall away. I told the investing world in March 2008 that it's going to take three years to get through the first phase of this, and

In many ways eBay was the first social network. It's a highly engaged community-based shopping experience.

by and large investors have responded. The market understands if you create clear expectations of what you're trying to accomplish and what's achievable by when. Then the challenge of leadership, whether you're a CEO or part of the leadership team, is to execute against those commitments, and that's what we've tried to do.

What's the biggest difference between being an important guy at a company like eBay and being the CEO?

As the CEO you are in the public eye, and the aura and the environment around you really reflect the successes and failures of the company. It takes a little bit of getting used to.

I've always thought it's easier to be number one than number two.

It's just different. For me they're both learning experiences. I like being number one.

Another topic you've probably thought a lot about is executive compensation. I think your total compensation package is $10 million. Are you worth $10 million?

[Laughs] One of the things that has been enormously eye-opening is watching how public-company compensation gets reported and how Black-Scholes evaluations play out. It's misleading, in my opinion, but my job is to drive value for our customers, and ultimately that will drive value in our company. My compensation is closely tied to what the stock price does, so if I drive value over time, I'll be fairly rewarded for that.

In terms of generating value, where do you see future growth for this company?

E-commerce is still in its early days. Today it's 5% of offline retail. That's going to easily go to 10%, 15%, 20%. Our market is going to have enormous growth, and eBay and PayPal will benefit from that. I think PayPal will be larger than eBay at some point, because it's serving all of e-commerce.

Social media are moving quickly, and a company like yours needs to keep pace. How do you do that?

Well, in many ways eBay was the first social network. It's a highly engaged community-based shopping experience, and we're trying a variety of things. We had a group-gifting product for the holidays, where you could identify a gift for a friend, engage your Facebook networks to help pay for it, and then use PayPal to make that easy. Take what's happening in the Facebook world and overlay it with what's happening in the commerce world, and you're going to see a tremendous number of innovations and experiments. Our job is to drive them and see which ones consumers really respond to. That's what makes the internet fun.

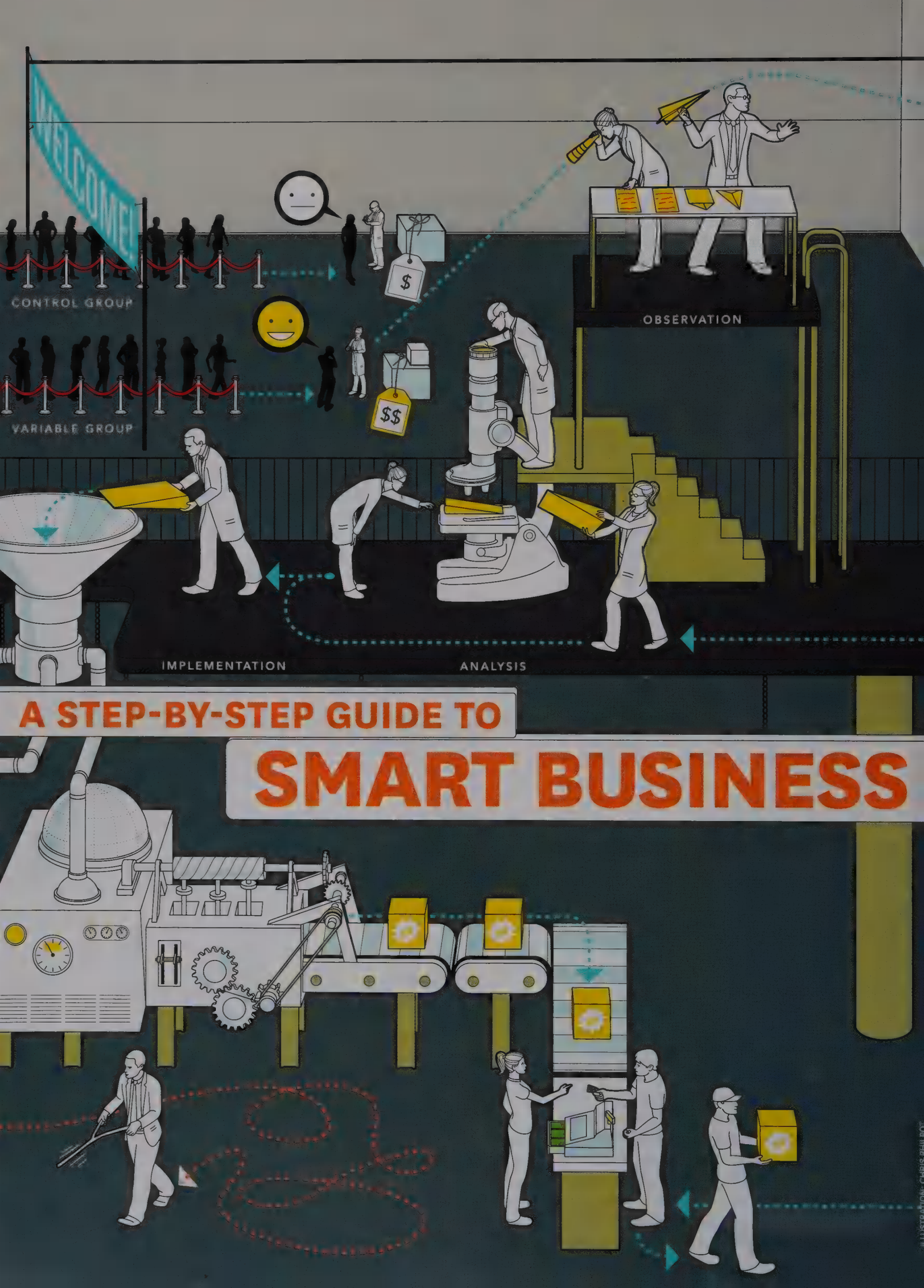
Speaking of fun, I've read that eBay executives assign one another cartoon personae, and that you're Dennis the Menace. What are we supposed to make of that?

I think it probably means that I tend to have a smile on my face and be relatively polite, but I have a bit of a devilish side behind that—and also perhaps a tougher side than people are aware of. So thank you, Mr. Wilson.

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"Sit up, Becker—you haven't earned a slouch."



A STEP-BY-STEP GUIDE TO SMART BUSINESS



EXPERIMENTS

Every company can profit from testing customers' reactions to changes. Here's how to get started.

by Eric T. Anderson and Duncan Simester

OVER THE PAST DECADE, managers have awakened to the power of analytics. Sophisticated computers and software have given companies access to immense troves of data: According to one estimate, businesses collected more customer information in 2010 than in all prior years combined. This avalanche of data presents companies with big opportunities to increase profits—if they can find a way to use it effectively.

The reality is that most firms can't. Analytics, which focuses on dissecting past data, is a complicated task. Few firms have the technical skills to implement a full-scale analytics program. Even companies that make big investments in analytics often find the results difficult to interpret, subject to limitations, or difficult to use to immediately improve the bottom line.

Most companies will get more value from simple business experiments. That's because it's easier to draw the right conclusions using data generated through experiments than by studying historical transactions. Managers need to become adept at using basic research techniques. Specifically, they need to embrace the "test and learn" approach: Take one action with one group of customers, take a different action (or often no action at all) with a control group, and then compare the results. The outcomes are simple to analyze, the data are easily interpreted, and causality is usually clear. The test-and-learn approach is also remarkably powerful. Feedback from even a handful of experiments can yield immediate and dramatic improvements in profits. (See the sidebar "How One Retailer Tested Its Discount Strategy.") And unlike analytics, experimentation is a skill that nearly any manager can acquire.

Admittedly, it can be hard to know where to start. In this article, we provide a step-by-step guide to conducting smart business experiments.

It's All About Testing Customers' Responses

In some industries, experimentation is already a way of life. The J. Crew or Pottery Barn catalog that arrives in your mailbox is almost certainly part of an experiment—testing products, prices, or even the weight of the paper. Charitable solicitations and credit card offers are usually part of marketing tests, too. Capital One conducts tens of thousands of experiments each year to improve the way it acquires customers, maximizes their lifetime value, and even terminates unprofitable ones. In doing so, Capital One has grown from a small division of Signet Bank to an independent company with a market capitalization of $19 billion.

The ease with which companies can experiment depends on how easily they can observe outcomes. Direct-mail houses, catalog companies, and online retailers can accurately target individuals with different actions and gauge the responses. But many companies engage in activities or reach customers through channels that make it impossible to obtain reliable feedback. The classic example is television advertising. Coke can only guess at how viewers responded to its advertising during the last Olympics, a limitation recognized by John Wanamaker's famous axiom, "Half the money I spend on advertising is wasted; the trouble is, I don't know which half." Without an effective feedback mechanism, the basis for decision making reverts to intuition.

In practice, most companies fall somewhere between these two extremes. Many are capable of conducting tests only at an aggregate level, and they're forced to compare nonequivalent treatment and control groups to evaluate the response. If Apple wants to experiment with the prices of a new iPhone, it may be limited to charging different prices in different countries and observing the response. In general, it's easier to experiment with pricing and product decisions than with channel management or advertising decisions. It's also easier to experiment in consumer settings than in business-to-business settings, because B2C markets typically have far more potential customers to serve as subjects.

Think Like a Scientist

Running a business experiment requires two things: a control group and a feedback mechanism.

Though most managers understand the purpose of control groups in experimentation, many companies neglect to use them, rolling out tests of new offerings across their entire customer base. A company that wants to evaluate the effect of exclusivity on its dealer network, for instance, is missing an opportunity if it offers all its dealers exclusivity. It should maintain nonexclusivity in certain regions to make it easier to evaluate how exclusivity affects outcomes.

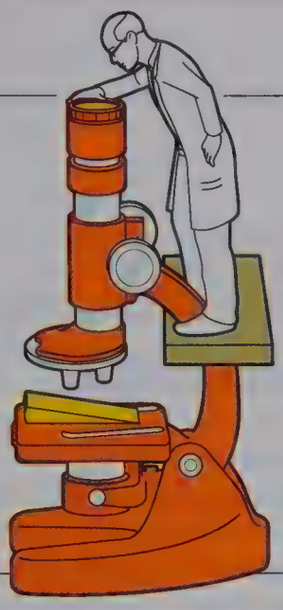
Ideally, control groups are selected through randomization. When Capital One wanted to test the effectiveness of free transfers of balances from other

Overcoming Reluctance to Experiment

A large bank we worked with decided to use experiments to improve the way it advertised its certificates of deposit, a core product. In the past, decisions on ads had been made largely by a single manager, whose extensive experience endowed him with power and status within the organization—and a big salary.

The possibility that the bank would use experiments to supplant his intuitive decision making was a threat to the manager. Not surprisingly, he obstructed the process, arguing that planning lead times were too long and decisions had already been made. A senior leader whose P&L was directly affected by the advertising decisions had to intervene. He allowed the experiments to go forward—and reassured his team that any missteps resulting from the experiments would not affect their year-end bonuses.

Organizational recalcitrance is one of the key hurdles companies encounter when trying to create a culture of experimentation. The main obstacle to establishing the new usual



Idea in Brief

Companies today understand the power of analytics, but dissecting past data is a complicated task that few firms have the technical skills to master. Most companies will get more value from simple business experiments.

To grow profits, managers need to become adept at techniques used by lab scientists and medical researchers: They should establish control and treatment groups to test the effects of changes in price, promotion, or product variation. They should also grasp the opportunities provided by general changes in the business—like store openings—that constitute natural experiments in consumer behavior.

Creating a culture of experimentation requires companies to overcome internal political and organizational obstacles. And not every experiment will succeed. But over time, companies that embrace a test-and-learn approach are more apt to find the golden tickets that will drive growth.

credit cards (the innovation that initially launched its success), it offered the promotion to a random sample of prospective customers, while a different random sample (the control group) received a standard offer. Often it makes sense for a company to set up a treatment group and then use the remainder of the customer base as a control group, as one bank did when it wanted to experiment with its online retail trading platform. That approach gave bank managers a very large sample of equivalent customers against which to evaluate the response to the new platform.

The key to success with treatment and control groups is to ensure separation between them so that the actions taken with one group do not spill over to the other. That can be difficult to achieve in an online setting where customers may visit your website repeatedly, making it challenging to track which versions of the site they were exposed to. Separation can also be hard to achieve in traditional settings, where varying treatments across stores may lead to spillovers for customers who visit multiple stores. If you cannot achieve geographic separation, one solution may be to vary your actions over time. If there is concern that changes in underlying demand may confound the comparisons across time, consider repeating the different actions in multiple short time periods.

The second requirement is a feedback mechanism that allows you to observe how customers respond to different treatments. There are two types of feedback metrics: behavioral and perceptual. Behavioral metrics measure actions—ideally, actual purchases. However, even intermediate steps in the purchasing process provide useful data, as Google's success illustrates. One reason Google is so valuable to advertisers is that it enables them to observe behavioral expressions of interest—such as clicking on ads. If Google could measure purchases rather than mere clicks, it would be even more valuable. Of course, Google and its competitors realize this and are actively exploring ways to measure the effects

is the old usual. Organizations have their ways of making decisions, and changing them can be a formidable challenge.

One mistake some firms make is to delegate experimentation to a customer intelligence group. This group has to lobby each business unit for the authority to conduct experiments. That's the wrong approach: Experiments are designed to improve decision making, and so responsibility for them must occur where those decisions are made—in the business units themselves.

It is also important to set the right expectations. It's a mistake to expect every experiment to discover a more profitable approach—perhaps only 5% of them will do that. Those odds mean that taking eight months to implement a single large-scale experiment is a bad strategy. Productive experimentation requires an infrastructure to support dozens of small-scale experiments. Of perhaps 100 experiments, only five to 10 will look promising and can be replicated, yielding one to two actions that are almost certain to be profitable. Focus your organization on these and scale them hard. Your goal, at least initially, is to find the golden ticket—you're not looking for lots of small wins.

Golden tickets can be hard to find, but that's largely because most organizations lack the perseverance to overcome the institutional resistance that stands in the way of discovering them.

Much of what companies learn from mammoth experiments can be gleaned from smaller tests that involve fewer variables, saving resources for follow-up tests.

of advertising on purchasing decisions in online and traditional channels.

Perceptual measures indicate how customers think they will respond to your actions. This speculative form of feedback is most often obtained via surveys, focus groups, conjoint studies, and other traditional forms of market research. These measures are useful in diagnosing intermediate changes in customers' decision processes.

Given that the goal of most firms is to influence customers' behavior rather than just their perceptions, experiments that measure behavior provide a more direct link to profit, particularly when they measure purchasing behavior.

Seven Rules for Running Experiments

As with many endeavors, the best experimentation programs start with the low-hanging fruit—experiments that are easy to implement and yield quick, clear insights. A company takes an action—such as raising or lowering a price or sending out a direct-mail offer—and observes customers' reactions.

You can identify opportunities for quick-hit experiments at your company using these criteria.

1 Focus on individuals and think short term. The most accurate experiments involve actions to individual customers, rather than segments or geographies, and observations of their responses. The tests measure purchasing behavior (rather than perceptions) and reveal whether changes lead to higher profits. Focus your experiments on settings in which customers respond immediately. When UBS was considering how to use experiments to improve its wealth management business, it recognized that the place to start was customer acquisition, not improving lifetime customer value. The effects of experiments on customer acquisitions can be measured immediately, while the impact on customer lifetime value could take 25 years to assess.



2 Keep it simple. Look for experiments that are easy to execute using existing resources and staff. When a bank wanted to run a customer experiment, it didn't start with actions that required retraining of retail tellers. Instead, it focused on actions that could be automated through the bank's information systems. Experiments that require extensive manipulation of store layout, product offerings, or employee responsibilities may be prohibitively costly. We know one retailer that ran a pricing experiment involving thousands of items across a large number of stores—a labor-intensive action that cost more than $1 million. Much of what the retailer learned from that mammoth experiment could have been gleaned from a smaller test that used fewer stores and fewer products and preserved resources for follow-up tests.

3 Start with a proof-of-concept test. In academic experiments, researchers change one variable at a time so that they know what caused the outcome. In a business setting, it's important to first establish proof of concept. Change as many variables in whatever combination you believe is most likely to get the result you want. When a chain of convenience stores wanted to test the best way to shift demand from national brands to its private-label brands, it increased the prices of the national brands and decreased the private-label brand prices. Once it established that shifting demand was feasible, the retailer then refined its strategy by varying each of the prices individually.

4 When the results come in, slice the data. When customers are randomly assigned to treatment and control groups, and there are many customers in each group, then you may effectively have multiple experiments to analyze. For example, if your sample includes both men and women, you can evaluate the outcome with men and women separately. Most actions affect some customers more than others. So when the data arrive, look for subgroups within your control and treatment groups. If you examine only aggregate data, you may incorrectly conclude that there no effects on any customers. (See the exhibit "Slicing an Experiment.")

The characteristics that you use to group customers, such as gender or historical purchasing patterns, must be independent of the action itself. For example, if you want to analyze how a store opening affects catalog demand, you cannot simply compare

customers who made a purchase at the store with customers who did not. The results will reflect existing customer differences rather than the impact of opening the store. Consider instead comparing purchases by customers who live close to the new store versus customers who live far away. As long as the two groups are roughly equivalent, the differences in their behavior can be attributed to the store opening.

5 Try out-of-the-box thinking. A common mistake companies make is running experiments that only incrementally adjust current policies. For example, IBM may experiment with sales revenues by varying the wholesale prices that it offers to resellers. However, it may be more profitable to experiment with completely different sales approaches—perhaps involving exclusive territories or cooperative advertising programs. If you never engage in "what-if" thinking, your experiments are unlikely to yield breakthrough improvements. A good illustration is provided by Tesco, the UK supermarket chain. It reportedly discovered that it was profitable to send coupons for organic food to customers who bought wild birdseed. This is out-of-the-box thinking. Tesco allows relatively junior analysts at its corporate headquarters to conduct experiments on small numbers of customers. These employees deliver something that the senior managers generally don't: a steady stream of creative new ideas that are relevant to younger customers.

6 Measure everything that matters. A caution about feedback measures: They must capture all the relevant effects. A large national apparel retailer recently conducted a large-scale test to decide how often to mail catalogs and other promotions to different groups of customers. Some customers received 17 catalogs over nine months, whereas another randomly selected group received 12 catalogs over the same time period. The retailer discovered that for its best customers the additional catalogs increased sales during the test period, but lowered sales in subsequent months. When the retailer compared sales across its channels, it found that its best customers purchased more often through the catalog channel (via mail and telephone) but less from its online stores. When the firm aggregated sales across the different time periods and across its retail channels, it concluded that it could mail a lot less

How One Retailer Tested Its Discount Strategy

Walk into any large retail store, and you'll find price promotions being offered on big national brands—discounts that are funded by the manufacturer. For retailers, these promotions can be a mixed bag: Although the lower prices may increase sales of the item, the promotion may hurt sales of competing private-label products, which offer higher margins. We worked with one national retailer that decided to conduct experiments to determine how it might shield its private-label market share by promoting these products while the national brands were on sale.

The retailer designed six experimental conditions—a control and five discount levels that ranged from zero to 35% for the private-label items. The retailer divided its stores into six groups, and the treatments were randomized across the groups. This meant each store had a mixture of the experimental conditions distributed across the different products in the study. For example, in Store A private-label sugar was discounted 20%, and private-label mascara was full price, whereas in Store B mascara was discounted, but sugar was not. This experimental design allowed the retailer to control for variations in sales that occurred because the store groups were not identical.

The test revealed that matching the national brand promotions with moderate discounts on the private-label products generated 10% more profits than not promoting the private-label items. As a result, the retailer now automatically discounts private-label items when the competing national brands are under promotion. After establishing proof of concept, it refined its shielding policies by testing responses to various types of national brand promotions. For example, it discovered that a "Buy One, Get One for 50% Off" promotion on a national brand should also be matched with the same offer on the private label, rather than just a straight discount.

These experiments were successful for two main reasons: The actions were easy to implement, and the results were easy to measure. Each set of experiments lasted just one week. There were few enough products involved that stores did not require any additional labor. The experiments piggybacked on the standard procedures for promoting an item—indeed, the store employees were unaware that they were helping to implement an experiment.

In previous experiments the retailer had learned that if it changed too many things at once, the stores could not handle the implementation without long delays and a lot of additional cost. In some cases temporary labor had to be trained to go into the stores, find the products, and change the prices and shelf signage. Moreover, if the experiment extended beyond a week, problems arose as shelves were constantly rearranged and new signs applied. A maintenance program was required to monitor store compliance. In effect the retailer experimented on experimentation itself—it learned how to design studies that it could analyze more quickly and implement more easily.



Slicing an Experiment

When you're conducting an experiment, it's important to remember that initial results may be deceiving. Consider a publishing company that tried to assess how discounts affect customers' future shopping behavior. It mailed a control group of customers a catalog containing a shallow discount—its standard practice. The treatment group of customers received catalogs with deep discounts on certain items. For two years, the company tracked purchases at an aggregate level, and the difference between the two groups was negligible:

ALL CUSTOMERS

PER CUSTOMER

Customers who received the catalog with shallow discounts spent: **$159** CONTROL

Customers who received the catalog with deep discounts spent: **$157** TEST

$(2) CHANGE

But that view of the data did not tell the whole story. Further analysis revealed a disturbing outcome among customers who had recently purchased a high-priced item and then received a catalog offering the same item at a 70% discount. Apparently upset by this perceived overcharge, these customers (some of them long-standing ones) cut future spending by 18%:

CUSTOMERS WHO RECENTLY BOUGHT A HIGH-PRICED ITEM

PER CUSTOMER

Customers who received the catalog with shallow discounts spent: **$506** CONTROL

Customers who received the catalog with deep discounts spent: **$415** TEST

$(91) CHANGE

Upon learning these results, the publishing firm modified its direct-mail approach to avoid inadvertently antagonizing its best customers.

frequently to its best customers without sacrificing sales. Viewing results in context is critical whenever actions in one channel affect sales in other channels or when short-term actions can lead to long-run outcomes. This is the reason that we recommend starting with actions that have only short-run outcomes, such as actions that drive customer acquisition.

7 Look for natural experiments. The Norwegian economist Trygve Haavelmo, who won the 1989 Nobel Prize, observed that there are two types of experiments: "those we should like to make" and "the stream of experiments that nature is steadily turning out from her own enormous laboratory, and which we merely watch as passive observers." If firms can recognize when natural experiments occur, they can learn from them at little or no additional expense. For example, when an apparel retailer opened its first store in a state, it was required by law to start charging sales tax on online and catalog orders shipped to that state, whereas previously those purchases had been tax-free. This provided an opportunity to discover how sales taxes affected online and catalog demand. The retailer compared online and catalog sales before and after the store opening for customers who lived on either side of the state's southern border, which was a long way from the new store. None of the customers were likely to shop in the new store, so its opening would have no effect on demand—the only change was the taxation of online and catalog purchases, which affected consumers only on one side of the border. The comparison revealed that the introduction of sales taxes led to a large drop in online sales but had essentially no impact on catalog demand.

The key to identifying and analyzing natural experiments is to find treatment and control groups that were created by some outside factor, not specifically gathered for an experiment. Geographic segmentation is one common approach for natural experiments, but it will not always be a distinguishing characteristic. For example, when GM, Ford, and Chrysler offered the public the opportunity to purchase new cars at employee discount levels, there was no natural geographic separation—all customers were offered the deal. Instead, to evaluate the outcome of these promotions, researchers compared transactions in the weeks immediately before and after the promotions were introduced. Interestingly, they discovered that the jump in sales levels was accompanied by a sharp increase in prices. Customers thought they were getting a good deal, but in reality



Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

prices on many models were actually lower before the promotion than with the employee discount prices. Customers responded to the promotion itself rather than to the actual prices, with the result that many customers were happy with the deal, even though they were paying higher prices.

Avoid Obstacles

Companies that want to tap into the power of experimentation need to be aware of the obstacles—both external and internal ones. In some cases, there are legal obstacles: Firms must be careful when charging different prices to distributors and retailers, particularly firms competing with one another. Although there are fewer legal ramifications when charging consumers different prices (the person sitting next to you on your airline flight has usually paid more or less than you), the threat of an adverse consumer reaction is a sufficient deterrent for some firms. No one likes to be treated less favorably than others. This is particularly true when it comes to prices, and the widespread availability of price information online means that variations are often easily discovered.

The internal obstacles to experimentation are often larger than the external barriers. In an organization with a culture of decision making by intuition, shifting to an experimentation culture requires a fundamental change in management outlook. Management-by-intuition is often rooted in an individual's desire to make decisions quickly and a culture that frowns upon failure. In contrast, experimentation requires a more measured decision-making style and a willingness to try many approaches, some of which will not succeed.

Some companies mistakenly believe that the only useful experiments are successful ones. But the goal is not to conduct perfect experiments; rather, the goal is to learn and make better decisions than you are making right now. Without experimentation, managers generally base decisions on gut instinct. What's surprising is not just how bad those decisions typically are, but how good managers feel about them. They shouldn't—there's usually a lot of room for improvement. Organizations that cultivate a culture of experimentation are often led by senior managers who have a clear understanding of the opportunities and include experimentation as a strategic goal of the firm. This is true of Gary Loveman, the CEO of Harrah's, now called Caesars Entertainment, who transformed the culture of a 35,000-employee organization to eventually enshrine experimentation as a core value. He invested in the people and infrastructure required to support experimentation and also enforced a governance mechanism that rewarded this approach. Decisions based solely upon intuition were censured, even if the hunch was subsequently proved correct.

There is generally a practical limit on the number of experiments managers can run. Because of that, analytics can play an important role, even at companies in which experiments drive decision making. When Capital One solicits new cardholders by mail, it can run thousands of experiments; there's no need to pretest the experiments by analyzing historical data. But other companies' business models may allow for only a few experiments; in such cases, managers should carefully plan and pretest experiments using analytics. For example, conducting experiments in channel settings is difficult because changes involve confrontation and disruption of existing relationships. This means that most firms will be limited in how many channel experiments they can run. In these situations, analyzing historic data, including competitors' actions and outcomes in related industries, can offer valuable initial insights that help focus your experiments.

> The goal is not to conduct perfect experiments; it is to make better decisions.

Whether the experiments are small or large, natural or created, your goal as a manager is the same: to shift your organization from a culture of decision making by intuition to one of experimentation. Intuition will continue to serve an important role in innovation. However, it must be validated through experimentation before ideas see widespread implementation. In the long run, companies that truly embrace this data-driven approach will be able to delegate authority to run small-scale experiments to even low levels of management. This will encourage the out-of-the-box innovations that lead to real transformation.

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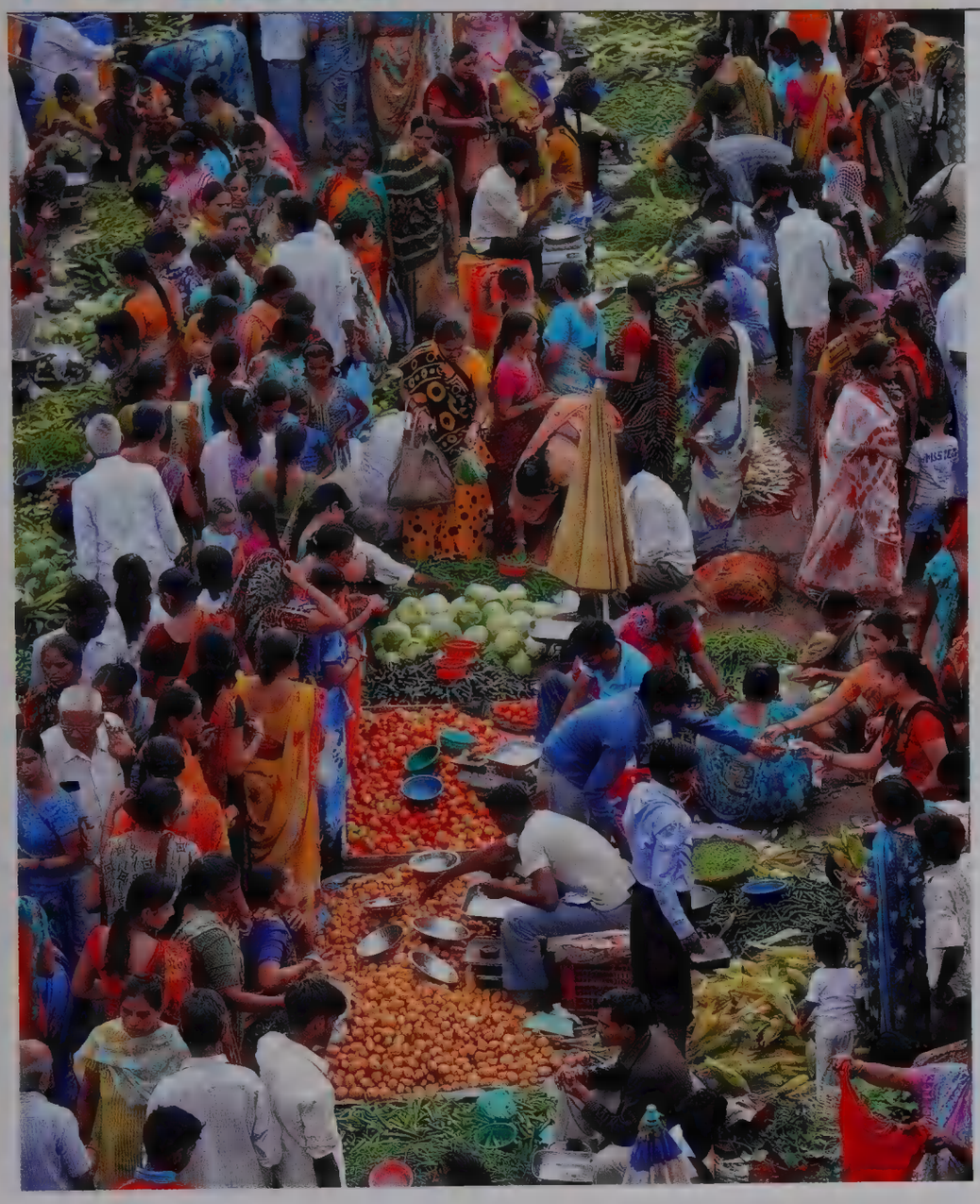
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Is the Bottom Of the Pyramid Really for You?

Searching for that pot of gold in the world's most challenging markets may not be worth your company's while. Here's how to make that call. *by Ashish Karamchandani, Mike Kubzansky, and Nishant Lalwani*

If your company is intrigued by the opportunities at the bottom of the pyramid but hesitant to plunge in, it's not alone: Despite the extent of the markets and the volume of the hype, few multinational firms have built sizable businesses serving people who survive on just a few dollars a day. Companies sense that profits in this market are elusive, and the evidence backs them up.

Apart from some successes in industries such as telecommunications, fast-moving consumer goods, and pharmaceuticals, global corporations have been largely unable to reduce costs and prices enough to serve poor consumers. Our research shows that a only minority of corporations that have engaged with poor populations have created businesses with 100,000 or more customers in Africa or 1 million in India. Procter & Gamble, for example, invested more than $10 million in its PUR water purification powder for bottom-of-the-pyramid markets—but eventually had to shift the product to its philanthropic arm because take-up struggled to exceed 5%. Sourcing from bottom-of-the-pyramid producers is not easy, either. Few companies, our research shows, have successfully integrated large numbers of small, disaggregated suppliers into their value chains.

The bottom of the pyramid clearly isn't for every company—or product or supply chain, even if a company is highly motivated to engage with this population.

Innovations that engage the poor often come not from industry players but from firms outside the mainstream.

Corporations often perceive better options elsewhere. Burgeoning middle classes in developing countries often provide targets that are less complicated to reach and require less alteration to corporations' usual ways of doing business. Similarly, many companies that purchase goods find it easier to deal with large, middle-income farmers or skilled urban workers in emerging markets than with producers at the bottom of the pyramid.

In fact, many innovations that engage the poor have come from players outside the mainstream in their industries. Take the financial sector, for example: Microfinance originated with NGOs, mobile money was developed primarily by telecom companies, and micromortgage companies in India are being launched by entrepreneurs and firms with no experience in the housing-finance sector. Established commercial banks, on the other hand, are usually saddled with legacy systems, fixed assets, regulatory requirements—and, occasionally, mindsets—that make it difficult for them to lead the innovation charge in financial services for the underserved.

But don't be too quick to give up on the bottom of the pyramid. The opportunities are as enticing as the late C.K. Prahalad showed them to be: The 4 billion people living in poverty represent $5 trillion worth of purchasing power. Monitor's research into more than 700 market-based initiatives for social change in India and Africa—drawing on 70-plus site visits as well as interviews with managers, sales teams, distributors, and some 1,500 customers—reveals that the barriers to the low-income market can be overcome. In this article, we'll show the ways in which smart companies have managed to surmount those barriers. We'll also show how innovative thinking has opened new markets.

Barriers in Search of Solutions

Success at the bottom of the pyramid requires companies to adapt their business models for environments that are very different from their core markets. As Prahalad pointed out, much engagement with bottom-of-the-pyramid consumers requires selling low-margin products in high volume. Multinationals often find that their prices are too high for this population, and their usual supply chains, production methods, and delivery systems present formidable hindrances to slashing costs.

Companies seeking to source agricultural products or other goods from the bottom of the pyramid face significant obstacles of their own: Although small-scale growers or decentralized workers are often the lowest-cost producers, the expense of distributing inputs, collecting output, and monitoring and training these far-flung rural suppliers can be prohibitive. For example, Coca-Cola would not have been able to source from small farmers for its juice-processing operations in Uganda and Kenya had it not been for millions of dollars in foundation funds that were committed to the training and organizing of farmers there.

Partnering with NGOs and other organizations that have deep knowledge of customers is often suggested as a way for multinationals to gain knowledge and extend their reach. But many corporate executives have told us that they have abandoned such partnerships. The main reasons: a mismatch in priorities (social versus business), operational differences (differing quality standards, for example), and a perception that partners are not always transparent about their true objectives.

Executives doing business at the bottom of the pyramid recounted the same barriers again and again. Here are some of the most common, along with solutions that have allowed companies to get past them.

Uncertain cash flow. Consumer cash flow is an issue that many companies overlook in their quest to reduce prices. Bottom-of-the-pyramid customers aren't just poor; they live in a state of uncertainty. Up-front payments for certain products are simply out of the question. We found that many small farmers in Kenya, for example, don't buy fertilizer, even though they are aware of its benefits, because they can't afford the 50-kilogram bags it comes in.

Repackaging offerings in small amounts is a well-known way to overcome the cash-flow barrier. Other solutions include using credit (when available) to reduce up-front payments and accepting payment in installments. Pay-per-use strategies allow the customer to pay for use of the asset without bearing the full capital cost. The Muthoot Pappachan Group, one of India's largest gold-loan companies, encourages low-income customers to make small daily payments toward the purchase of gold, which is highly prized by Indians and serves as a savings vehicle. The pay-per-use strategy has been employed successfully in areas such as private primary education in Ghana, irrigation pumps in India, and clean drinking water in the Philippines.

Pay-per-use strategies have been employed successfully in areas such as private primary education, irrigation pumps, and water purification.

Do You Have What It Takes?

Here are a few questions executives should ask themselves about their companies before plunging into markets at the bottom of the pyramid.

Can we manage large numbers of low-margin, low-value transactions?

Companies whose business models depend on generating high margins at each stage of the value chain are unlikely to have production and distribution systems suited to low-income markets.

Can we work with informal markets?

A company whose distribution practices are built on, for example, proper trading paperwork or certification of suppliers may feel ill at ease operating at the bottom of the pyramid.

Can we keep out legacy and overhead costs?

Allocated legacy and overhead costs, such as IT, can make new products too expensive for the market and undercut profitability before they have a chance to take off.

Do our leaders have a long-range mind-set?

The low-margin, high-volume businesses at the bottom of the pyramid can take longer to generate healthy returns than those in other markets. Companies need patient sources of capital—many companies we spoke to in Africa cited five years as an expected investment horizon—dedicated teams, and leaders who will champion initiatives despite initial low returns.

Will our organizational culture stifle a bottom-of-the-pyramid innovation?

Initiatives in this market tend to be significant departures from companies' core businesses and thus are vulnerable to being crushed by traditional rules governing new-product development.

Another way to significantly reduce costs is to specialize and standardize. Specializing allows a company to eliminate or minimize whole classes of expenses while maintaining acceptable levels of quality. LifeSpring, a joint venture of the nonprofit Acumen Fund and the Indian public-sector corporation HLL Lifecare, operates a chain of 20-bed hospitals for maternity, doctor-assisted childbirth, and early pediatric care in southern India. The facilities, located in low-income neighborhoods, advertise by sending representatives to visit pregnant women in surrounding areas and giving customers discount vouchers to distribute. The hospitals' operations are extremely basic in order to keep costs down, as most patients pay from their pockets. The wards have no air-conditioning, and no food is provided. The company's narrow specialization (complicated cases are referred elsewhere) allows for the use of standard protocols by nurses who have less formal training than nurses in larger hospitals. Wages are thus lower, and there's less churn in staffing, because the demand for these nurses is limited.

Specialization also allows for higher utilization of physicians and a narrower range of supplies. LifeSpring's services cost 65% to 80% less than private-sector options—$90 for a vaginal delivery and $200 for a caesarean, for example.

Gauging demand. Confusing need with demand is a common problem among organizations serving the bottom of the pyramid. Many firms have wasted time and resources trying to market products that are designed for the poor but that consumers don't want. Our research with microfinance customers in rural India showed that when given a choice between beneficial products, such as solar-powered lanterns and low-energy stoves, and aspirational products like mobile phones and gold coins, 85% of customers opted for the latter.

It's usually difficult to make the economics work for a product if demand must be generated, because marketing costs typically swamp efforts to keep prices extremely low. Companies should focus on areas where they can meet existing demand, with either lower-cost and better-quality products than existing options, or simply cheaper ones. Safaricom's hugely successful M-Pesa, for example, offered money transfers by mobile phone in Africa at 33% of the cost of Western Union—and at 20% of the cost of (and much greater security than) long-distance bus companies, the customary provider.

Sales and distribution challenges. Although customers are numerous, they are often rural and scattered, and it's difficult for corporations to manage the face-to-face (and cash-based) interactions that are typically necessary for building a cost-effective distribution business. Channels built for middle-class and high-income customers, such as agent networks for selling insurance, don't reach the poor—even in urban areas—and extending them can be prohibitively expensive. The challenges go beyond making the initial sale: Multinationals that sell durable goods to villagers often rue the huge costs of meeting service warranties and replacing parts in far-flung locations.

One response to the distribution problem is to build a dedicated channel to serve the market. Innovative companies have found ways to reach low-income consumers through alternative channels that can provide additional value to customers. Some have teamed up with partners that have extensive reach in the market. Hindustan Unilever has difficulty reaching low-income customers and educating them about its Pureit water filters, so it

Managing the Risks

Companies face unique challenges in trying to build businesses at the bottom of the pyramid.

Image

Backlashes over issues such as exploitation—or the appearance of it—can be highly damaging. SKS Microfinance was criticized by Indian politicians and the press after its founders, investors, and top managers made hundreds of millions of dollars in an IPO last year while maintaining that the organization's primary mission was social impact. Demonstrate that commercial returns further community development rather than come at the expense of the poor.

Brand

A low-end version of your brand may reduce its attractiveness in some customers' eyes. Housing developers in India have told us that they worry that building low-income units could cheapen their premium brands. Avoid brand devaluation by creating a distinct name for a bottom-of-the-pyramid product.

Cannibalization

Your new low-cost product may siphon off existing customers. That was the concern of executives of a computer company in Africa, whose ultra-low-cost laptops could cut into demand for the firm's profitable midrange products. Market a bottom-of-the-pyramid product with a differentiated campaign, and, if possible, sell it through different channels.

Underestimating the Competition

Companies often overlook the tough competitors operating within the informal economy. For example, more than 90% of India's juice market is run by small players, many of whom don't conform to quality standards. These competitors may use radical tactics. Reliance, an Indian multinational, stopped selling fresh produce in some supermarkets after street vendors attacked its stores in 2007. Keep local competitors involved by employing them, giving them a role in the value chain, or even sourcing from them.

partners with microfinance institutions. Loan officers aggregate customers into groups, reducing Unilever's cost of marketing, and provide credit, making the product easier to pay for. (Because of microfinance's limited reach in most countries, however, this kind of solution is hardly universal.)

Where such partners are not available, we found innovative organizations improving upon, and distributing through, highly fragmented local networks. Bayer CropScience, a global firm that develops and manufactures crop protection products, used this strategy in Kenya to reach and educate small farmers about its Green World venture. The company introduced small packs of pesticides and trained a network of small, rural agrodealers to form "consultancy centers" that advise farmers on product handling and use. Bayer CropScience provides marketing support via radio and other means. The dealers were selected on the basis of such factors as their reputation in the community and their sales volumes. Kenya has nearly 5,000 agrodealers that stock the products, of which Bayer CropScience enlists only 4%, but Green World's dealers are some of the top performers in the country. About 25% of Bayer CropScience's horticultural retail revenues in Kenya now come from Green World stores.

Disaggregated providers. Small suppliers rarely have access to high-quality inputs (or the credit to buy them), they often lack training, and their output can be unreliable. Furthermore, companies that provide training and other benefits to suppliers may find that the outputs have been diverted elsewhere through "side selling."

Aggregating and assisting small producers through "contract farming" or other means have been effective in surmounting these problems. Global Green, an arm of Avantha, a $4 billion diversified Indian corporation, provides small farmers with drip irrigation and the inputs needed to grow Spanish gherkins, trains them in best practices, and buys the produce at a predetermined price that typically more than doubles farmers' income. To reduce costs, the company recruits farmers in clusters. It has set up regional processing centers, where the gherkins are cleaned, sorted, and packed for export. Side selling isn't a problem, because there's no local market in gherkins.

Other ways to prevent side selling include active monitoring of suppliers, indexing purchase prices to the market price, and making future participation contingent on compliance. These strategies for using small producers provide significant income increases for participating farmers while generating a steady, low-cost supply for the company that is sourcing. Some 75% of the poultry sector in Brazil relies on contract farming.

Undeveloped business ecosystems. The business ecosystems needed to support a product or service are often missing at the bottom of the pyramid. For example, once a rural entrepreneur has purchased a cow, where does she go for veterinary services? Innovative companies address the holes in the ecosystem by supplementing value chains end-to-end. For example, Amul, an Indian company that buys milk from 3 million dairy farmers, arranged for artificial insemination services for its small producers. Coca-Cola's manual distribution centers, known as MDCs, have been touted as an effective means of getting soft drinks into hard-to-reach urban areas in emerging markets, where infrastructure is poor and volumes are relatively low. What's not well known is that Coca-Cola did not just organize and recruit entrepreneurs to run these centers; it filled all the gaps along the value chain. Distribution-center owners take responsibility only for logistics and fulfillment. Coca-Cola handles such tasks as marketing, supply monitoring, and order taking.

Before Safaricom launched M-Pesa money transfers, it had very basic interactions with retail outlets, which merely sold airtime minutes. But the company's strategy of selling M-Pesa through retail agents required finding ways to manage store selection and the training and supervision of field agents. To do this effectively and at scale, Safaricom now outsources this

Hollard Group revitalized the insurance sector in Africa by selling simple funeral policies, building a base of 600,000 customers in five years.

work—for all 17,000 outlets—to Top Image, a specialist in these functions.

Creating New Kinds of Business

The most encouraging business-model innovations at the bottom of the pyramid manage to surmount multiple barriers at the same time. They represent not incremental adaptations but new, groundbreaking, end-to-end strategies.

Consider Voltic, Ghana's market leader in bottled water for middle-income consumers. When it decided to pursue low-income customers in the early 2000s, it chose a radical strategy: selling a premium product in a commodity market. Ghana, like much of West Africa, was already extensively served by informal vendors selling the 500-milliliter plastic pouches known as water sachets. Voltic raised the ante, introducing its Cool Pac brand at a slight premium and touting the product's higher quality.

Controlling costs was a problem, at first. Voltic produced the water centrally at its factory in Accra, but it soon found that the logistics and delivery costs to areas outside the capital were prohibitive, given the poor infrastructure. So the company set up distributed plants with more than a dozen franchisees, who had access to their own capital and an ability to run operations, from managing daily water quality to distributing the product through street hawkers. The franchisees split the operating margins with Voltic, which provided only half of the capital costs, made no investment in trucking capabilities, and retained control over the brand. Nearly half a million Cool Pac sachets are sold every day. (Voltic was acquired in 2009 by SABMiller.)

Hollard Group, an insurance company based in Johannesburg, took a different approach: It entered a largely informal market by developing a unique way of selling and servicing a beneficial product. Life insurance is usually only marginally successful at the bottom of the pyramid. Demand is low, and distribution costs are high. But in 2008, Hollard entered the funeral insurance market in Africa. The continent has a tradition of elaborate and expensive funerals, whose costs were often devastating to poor families. Informal burial societies and others were already providing services for this market, so funeral coverage was hardly a new idea. But Hollard introduced simple policies with affordable monthly premiums and sold them through PEP, a clothing and homewares retailer with 1,100 branches that targets the bottom of the pyramid in South Africa. A policy can be bought at the checkout counter as easily as a batch of cell-phone minutes. Hollard uses text messaging to remind clients about payments, and claims and processing are handled through mobile phones, rather than agents, reducing service costs. Consumers can pay their monthly premiums at any PEP outlet in cash. The firm has created a base of more than 600,000 customers in five years.

Another way to create new businesses at the bottom of the pyramid is to open markets that have been closed to the masses. The housing industry in urban India has boomed during the past decade, but the market serves just the wealthiest 15% of households. Some 40% to 60% of urban residents live in sprawling slums, and many others live in neighborhoods with limited facilities and unhygienic conditions. A new business model developed by Monitor is broadening the sector by bringing new-home costs down to levels that are affordable for people with lower incomes.

Traditionally, developers buy large tracts of land and build in phases. As each phase is constructed, the value of the remaining land increases. The developer staggers construction to maximize returns. This speculative "land as the asset" model results in ever-increasing prices for customers, long project timelines and high, though uncertain, returns for the developer. In contrast, using a low-income housing business model, a developer buys a small land parcel with basic infrastructure (transport availability, markets, and schools nearby) and sells all the housing as soon as building permits are issued. A 20% "down payment" from each customer, collected before a single brick is put in place, covers the cost of the land. The customer finances the rest of the construction, usually through loans from banks or housing finance companies. And the developer makes much of its profit when it delivers the housing. This is a low-capital business with great returns—if the turnaround is rapid. Also, as the profit per house is modest, volume is key. This business model requires a "manufacturing mind-set" and constant innovation that increases quality and reduces costs—in stark contrast to the traditional developer approach.

Some 50,000 low-income houses are estimated to go on sale by March 2011, with prices as low as $6,500. A World Bank study estimated the urban low-income housing market in India to be $220 billion.

FOR COUNTLESS firms, taking on the bottom of the pyramid simply isn't worth the disruption that's required to rethink business models. But for innovative multinationals, the obstacles are far from insurmountable—and the rewards are great.

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Ashish Karamchandani, Mike Kubzansky, and **Nishant Lalwani** lead Monitor Inclusive Markets, an initiative within the Monitor Group that focuses on catalyzing market-based solutions for social change.

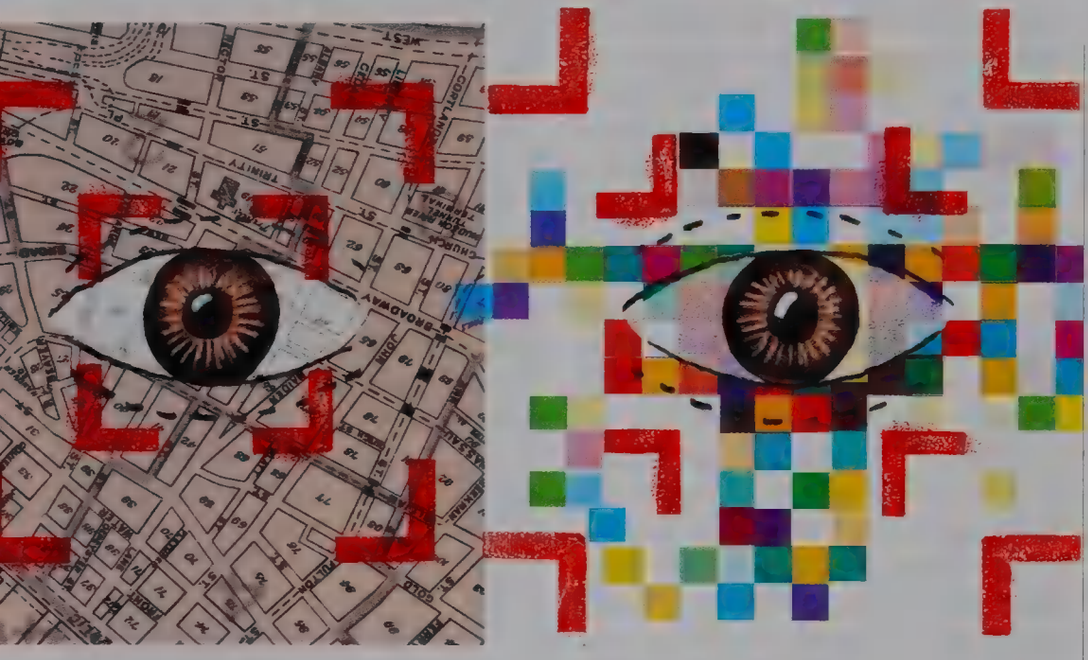
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MANAGING YOURSELF

Zoom In, Zoom Out

The best leaders know when to focus in and when to pull back. *by Rosabeth Moss Kanter*

After an explosion on a BP oil platform in the Gulf of Mexico in April 2010 killed 11 people and caused the biggest oil spill in U.S. history, the company's CEO at the time, Tony Hayward, zoomed in on the implications for his career. He appeared preoccupied with the incident's impact on BP's management and, particularly, on himself. About a week after the explosion, Hayward was quoted as saying to executives in his London office, "What the hell did we do to deserve this?" Despite PR coaching, a month later he told reporters, "I'd like my life back."

Hayward, who was forced to resign in July, had numerous opportunities to acknowledge the bigger picture: the human devastation and public consternation in the Gulf region. But even though BP deployed thousands of engineers to contain the spill, he could not, in public, rise above a 10-foot view; it was as though the crisis were his own personal devil. Hayward repeatedly focused on the small picture—trying, for example, to shift the blame to supplier Transocean, which had run the rig that exploded. His zoom button seemed to be stuck on the closest setting.

The lens through which leaders view the world can help or hinder their ability to make good strategic decisions, especially during crises. Zoom in, and get a close look at select details—perhaps too close to make sense of them. Zoom out, and see the big picture—but perhaps miss some subtleties and nuances.

Zoom buttons on digital devices let us examine images from many viewpoints. They also provide an apt metaphor for modes of strategic thinking. Some people prefer to see things up close, others from afar. Both perspectives—worm's-eye and bird's-eye—have virtues and pathologies. But they should be vantage points, not fixed positions. Leaders need multiple perspectives to get a complete picture. Effective leaders zoom in and zoom out.

I've come to this conclusion after more than 25 years of observing how leaders set strategic direction, interact with constituencies, and respond to unexpected events. I've worked with thousands of executives and conducted systematic studies of innovation, alliances, change, and transformation in hundreds of organizations. I've seen how organizational structures, processes, and cultures can direct the gaze of leaders close in or far out, and how levels of analysis can become default positions that limit effectiveness.

The zoom framework offers a dynamic model that can help current and aspiring leaders increase their own range of vision and establish conditions that enable others' success. In this article, I will identify the behavior and decision modes associated with zooming in and contrast them

with those for zooming out. I'll consider the structures and cultures that trap people in dysfunctional default positions, and I'll conclude with ideas on developing capabilities for zooming to all levels.

Zooming In

Zooming in brings the details into sharp focus. Any opportunities look large and compelling, though they may lack some context.

A CEO I will call "John Jones"—who owns a midsize retail chain started by his father—works primarily in close-in mode. A classic entrepreneur who combines hustle with retail-is-detail know-how, Jones expanded the chain successfully from two to 30 locations by continually seeking the next prime site, merchandise item, or website tip. His discoveries came mostly through his personal connections rather than analysis. Jones disdained strategic plans and management theories. He removed a well-regarded banker from his advisory board, for instance, because the banker would ask for plans—orderly goals, with timelines—when Jones simply wanted to concentrate on specific operational ideas that were easy to implement.

Thanks to his industry knowledge, wide personal network, and intuition, zooming in served Jones well for a decade. But when the economy soured, his good instincts felt insufficient. Family members and key employees began to question his decisions. Jones had no succession plan—nobody had been groomed for the future. He made acquisitions on the basis of his own taste or just because an owner wanted to sell, and gave little thought to cost, whether the acquisition was a good fit, or what else was on the horizon. He had no broad theory about which opportunities to pursue and no industry map. Zooming in was limiting his company's growth prospects.

Close-in managers look for immediate benefits and make ad hoc decisions. They often favor one-on-one conversations over group meetings. They want to address details by doing whatever occurs to them. Faced with a problem, they look for quick fixes rather than stand back to seek underlying causes, alternatives, or long-term solutions. They prefer to contact someone they know rather than search more widely for expertise. These tendencies are exacerbated in organizations that restrict information flow, reward quick hits, and confine people to their roles.

A close-in perspective is often found in relationship-intensive settings, where human talent is the primary asset. Consider another executive, whom I'll call "Sam Lee." He ran a well-regarded professional services firm during a decade of incremental growth. Known as a benign leader, Lee could talk about strategies with external constituents, but he operated best when zooming in. He liked to confer in a clublike huddle in his office rather than discuss issues in open meetings. He was unfailingly helpful with individual requests (including one-off favors). In other words, he liked to make exceptions instead of policies. As a result, his organization had an abundance of private deals with individual staff members (such as off-calendar budget allocations, vacation privileges, sabbaticals, and extended family leaves).

In a time of prosperity with few external threats, a personal approach may be acceptable. Toward the end of Lee's tenure, however, the firm found itself in an increasingly competitive environment with greater regulatory pressure. It was becoming untenable to treat each situation as unique. Even as policy exceptions accumulated, the logic behind these decisions remained unaddressed. Junior professionals were left to wonder and worry about the rules and fairness. Whispered concerns about favoritism ran through the corridors. The organization was running on a patronage system of personal credits and debits, with a market for favors substituting for principle-based decision making. Morale and productivity declined, jeopardizing the company's reputation and making it harder to attract the best talent. When Lee



Are You Stuck in A Perspective That's **Too Close In?**

TELLTALE SIGNS	QUESTIONS THAT WILL HELP YOU ZOOM OUT
You get overwhelmed by countless details	What is the context? What matters most?
You take things personally, finding the "me" angle first	What larger purpose is being served? What is at stake for others?
You trade favors, hoping others will "do it for me"	Why is the task or mission worthy of support?
You make exceptions or special deals based on particular circumstances	Will the circumstances recur? What policies or decision frameworks could be used?
You jump on any good-looking offer that pops up	Does this fit the goal or destination? What else might be on the horizon?
You treat every situation as unique	Are there other similar situations? What categories or groupings make sense?

retired, his successor immediately zoomed out, stating a few broad strategic priorities. He created clear formal policies to replace informal exceptions and began discussing them all openly in large meetings.

One of the traps of zooming in is that policies and systems are based on internal politics. Close-in people tend to talk about their personal lives, as though self-disclosure will beget the same from others, turning organizational actions into an exchange of favors based on special relationships. They often resist change because it disrupts the social equilibrium. Sometimes their personal approach is valuable, because people respond faster to individuals they know than to abstract appeals. But "do it for me" is a weak basis for corporate decisions. It also means that employees cannot easily stand in for one another, because relationships are "owned" by specific people. And it can put ego above institution.

Relying heavily on personal instinct and interpersonal deals without a wider perspective or a long-term rationale can prove perilous. An overly personal approach can also make managers quick to perceive slights, whether or not they're real. The CEO of one technology company, though known as a great strategist, still let zooming in drive some decisions. He was personally offended by how a prominent magazine had portrayed him, so the company stopped advertising there. Employees took this as a warning to tread carefully when providing him with unfavorable information. In another case, a corporate middle manager pored over e-mails to see whether he was being treated appropriately, and complained immediately if he perceived any suggestion of offense. His focus on status over substance cost him a higher-paying position; the plum promotion went instead to a manager with a grasp of the bigger picture.

Zooming in can obscure the big picture, leading managers to overlook important issues. Decisions become based on who you are and whom you know, not on broader goals.

Zooming in can also lead to turf protection. When managers use territorial language, it reveals that they have fallen into this trap. One division CFO, for instance, always used the first person when referring to budget numbers, as in "I have x dollars," even though it was the organization's money, and ignored repeated requests from other members of the executive group to stop this manner of speaking.

Personalizing is not the same thing as self-reflection—indeed, it might be the opposite. Self-reflection is a learning process that requires a distant perspective on one's own behavior, in context. An obsession with self is reinforced by zooming in, but self-awareness stems from zooming out.

Zooming Out

Zooming out is essential to big-picture decision making. When people are far out, they can map the whole territory before taking action. They see events as examples of general patterns rather than as idiosyncratic or personal incidents. They put things in context and stress principles.

The former CEO of Garanti Bank, Akin Ongor, led it from a middle-of-the-road bank in Turkey to global prominence by setting up processes that replaced poor performers and upgraded talent. When his announcement of layoffs provoked union protests and even death threats, Ongor refused to take the attacks personally or get drawn into ad hominem battles. Instead, he went to the media and elevated the discussion to the principles behind the bank's actions. By zooming out, he helped his employees, the public, and government officials see the layoffs in the context of a transition in the economy and as a move that would save an important institution so that it could create more jobs in the future. The protests ended, and Ongor continued to lead successful change at the bank.

Zooming out helps people see the map and stay focused on larger principles. Consider Procter & Gamble CEO Robert McDonald, who rose through the ranks to head a global public company with a long-established culture. Even while seeking current profits, he constantly asks questions about what will support the sustainability of the company and keep its values intact. He can generalize about geographies and lines of business while appreciating cultural differences. He is personable but doesn't personalize issues, repeating often that he is a steward of an institution that must endure beyond him.

Zooming out helps people see the map and stay focused on larger principles. But it also has traps.

Zooming out is appropriate for top leaders. But it also has traps. For one thing, key stakeholders might want to see immediate results and know that the details are right before they support long-term big-picture thinking. That's why broad visions need to be matched by small wins that demonstrate feasibility. For another, leaders who like to be far out may operate so high above the fray that they don't see emerging threats and opportunities (which, ironically, is a danger for close-in leaders too) or recognize competing theories that are better able to explain new developments. Having zoomed out to examine all possible routes, they can neglect to notice the moment for action on one promising path. When zooming out makes established highways look too good, leaders may fail to jump onto a side road to get around the traffic.

When the focus is on grand theory, novel situations are dismissed as too insignificant to merit attention. Leaders lose the sense that the big picture might be contingent on a set of circumstances that may well evolve. But sometimes a novelty is a signal, heralding embryonic change. The film *The Social Network* presents a fictionalized version of an iconic moment

in which the Winklevoss brothers, feeling aggrieved that fellow student Mark Zuckerberg had created Facebook when he was supposedly working on their web venture, meet with the university president, a disguised version of then–Harvard president Lawrence Summers. In the movie, the president dismisses Facebook as just another undergraduate venture and tells the brothers to forget it and start another business rather than waste his time on something so trivial. Whether the incident was merely movie fiction or not, in real life that president was overly focused on important long-term plans and goals and on keeping a wide perspective on the institution. His lack of attention to interpersonal interactions eventually cost him support and his job.

Sometimes leaders need a nudge to look at details that might shake their theories. Take a chief executive I'll call "Herman Fry," who ran a science-based company that was starting to use genetic engineering in a growing product line. Fry had previously led a division to global prominence through breakthrough innovations and was known as a brilliant strategist and big-picture thinker. But when he heard rumblings against genetically modified ingredients in Europe, he initially dismissed them as local issues that didn't require scrutiny or a response. When he heard that a UK customer was being pressured about the same issue, his attention was caught—but not enough; he still said the concern was a minor blip and did not bother to look more deeply. By the time he was persuaded to gather more details, a global backlash had begun, and the company had lost the chance to reassure customers and tell its story ahead of the protests.

A preference for zooming out can make leaders appear remote and aloof. After a campaign that involved both inspiring rhetoric and street-level organizing, President Barack Obama faced severe national crises. He zoomed out to address big systemic issues, such as the financial crisis, with policies that advisers said stopped further erosion. But critics said that he failed to convince average Americans that he was addressing their problems. His supporters argued that his actions, Keynesian in nature, would show their merits in the longer run; yet as John Maynard Keynes himself pointed out, in the long run we're all dead. One of the problems with staying at the most distant end of the zoom is that the picture looks static and few routes are visible. It may appear, for instance, as though all economic highways go through the Federal Reserve and big banks. Zooming in, and monitoring the situation as it appeared to communities and families, might have helped Obama communicate that he was seeking alternatives that would reach more people directly—such as increasing small-business lending at local banks. Instead, despite his many accomplishments, Obama's approval ratings plummeted, and his party lost badly in the 2010 elections.



Are You Stuck in A Perspective That's Too Far Out?

TELLTALE SIGNS	QUESTIONS THAT WILL HELP YOU ZOOM IN
You dismiss deviations from plans or models as too minor to matter	Does the deviation challenge the model? How can the deviation be understood?
You veer away from dealing with specific problems in favor of focusing on general theory	What actions does your theory suggest for this particular problem?
You must have a full analysis or a big study before determining actions	Is there sufficient information to proceed in this instance? What are the costs of delay?
You always stay on major established paths	Are there side roads or shortcuts?
You pursue the mission regardless of human costs	How is this affecting the people who must carry out the mission?
You fit everything into a few general categories	What are the details that make things different? Which details matter?

Getting Stuck

A failure to zoom can spell doom. As we have seen, problems arise when people get stuck at one end of the scale and are unable to move to the other for a different perspective.

One question is whether it's possible to create teams that balance close-in and far-out modes. Perhaps. But if people can't shift from the worm's-eye or bird's-eye level, they often talk past one another. Those zooming in want to come back to the particulars and haggle over details, frustrating those who want patterns and a strategy. Those zooming out might seem theoretical and impractical, or find that their general frameworks and principles are not understood by those who zoom in. Hardened preferences can get in the way of good decisions.

A narrow focus in either direction can lead to trained incapacity, a concept attributed to social theorist Thorstein Veblen. Regardless of their innate potential, if people spend too much time on tasks that draw on only part of their repertoire, it can make the other part atrophy.

The fact that it's difficult to balance zooming in and zooming out may explain one perceived difference between male and female managers uncovered by Insead professor Herminia Ibarra. She found that women score high on all aspects of "21st century" leadership performance (such as relationship building, collaboration, and teamwork) except vision setting. Relationships are nurtured by zooming in. Vision involves zooming out. This may derive from the pernicious stereotypical view that men should be entrusted with big-picture decisions, while women should be assigned to caretaking tasks. The very nature of caretaking requires zooming in to be attentive to details, one child or one executive at a time. Zooming in is also a necessity for those whose fate depends on being attuned to the characteristics and preferences of power holders. Traditional divisions of labor by gender encourage men to zoom out and women to zoom in, with fewer opportunities to take another perspective.

Zooming Toward Both Perspectives

The best leaders work the zoom button in both directions. Faced with a crisis, they can address the immediate situation while seeking structural solutions. They can zoom in to see problems while zooming out to look for similar situations, root causes, and principles or policies that will help prevent the crisis from recurring.

Daniel Vasella, chairman and former CEO of pharmaceutical giant Novartis, was both a psychiatrist by training—which made him able to zoom in on the emotional state of the people around him—and a strategist with a theory of industry change that guided divestitures, acquisitions, and internal restructuring. He stressed personal values as well as global trends. Indra Nooyi, PepsiCo's CEO, blends a big-picture view of principles guiding the company, such as the need for transformation in food and beverage companies to promote improved health, with an ability to zoom in on the details of budget allocations for current business lines. Nooyi has defined new roles (such as a chief science officer) and new structures (for instance, the Global Nutrition Group, linked to central R&D) that help the previously decentralized organization both zoom out to a global perspective and zoom in on local differences.

> We don't have to divide the world into extremes—idiosyncratic or structural, situational or strategic, emotional or contextual—and choose one.

Effective leaders encourage others to expand their zooming range. For example, P&G, like most companies in the consumer packaged goods industry, is a heavy user of large-sample survey market research, which maps territories through statistical abstractions, a form of zooming out. Though P&G's leaders don't disregard these data, they also send employees into the field to live with families, zooming in on their needs and experiences. The closely observed details of individual household behaviors ultimately influence P&G's investment decisions.

The zoom function is more than a metaphor; it can be a way for people to stretch their mental capabilities by, for example, manipulating maps, comparing photos, exploring issues from various vantage points, and creating action plans that reflect learning from multiple perspectives. IBM's Corporate Service Corps integrates both the big and the small pictures into its global leadership development programs. It sends culturally diverse teams on monthlong field assignments in unfamiliar territory. The team members get direct experience solving specific problems on the ground while gaining a broad view across countries and cultures.

The language of zooming offers an objective way to discuss differences in perspective and encourage people to move to a different level: "Let's zoom in on that problem." "Let's zoom out to put it in perspective." Zoom-based checklists can help people stop themselves from overpersonalizing, reminding them to go up a few levels to the principles involved, or from overgeneralizing, encouraging them to get more grounded in situational realities. Everyone can apply the principles of zooming to his or her own job by asking the right questions, such as whether a given action fits the overall goal or whether there is sufficient information to move forward on a particular theory. (See the sidebars "Are You Stuck in a Perspective That's Too Close In?" and "Are You Stuck in a Perspective That's Too Far Out?")

THE ZOOMING idea suggests that we don't have to divide the world into extremes—idiosyncratic or structural, situational or strategic, emotional or contextual. The point is not to choose one over the other but to learn to move across a continuum of perspectives. President Bill Clinton's political genius was that he could "feel your pain" while putting events into historical and international context, zooming in and out quickly in a single conversation or speech. That dynamic capability is the essence of great strategic thinking.

Zooming can help leaders respond to events before they become crises. It can help them embrace new opportunities while continuing to operate with principles that build sustainable institutions for the long run. Leaders should make room to zoom.

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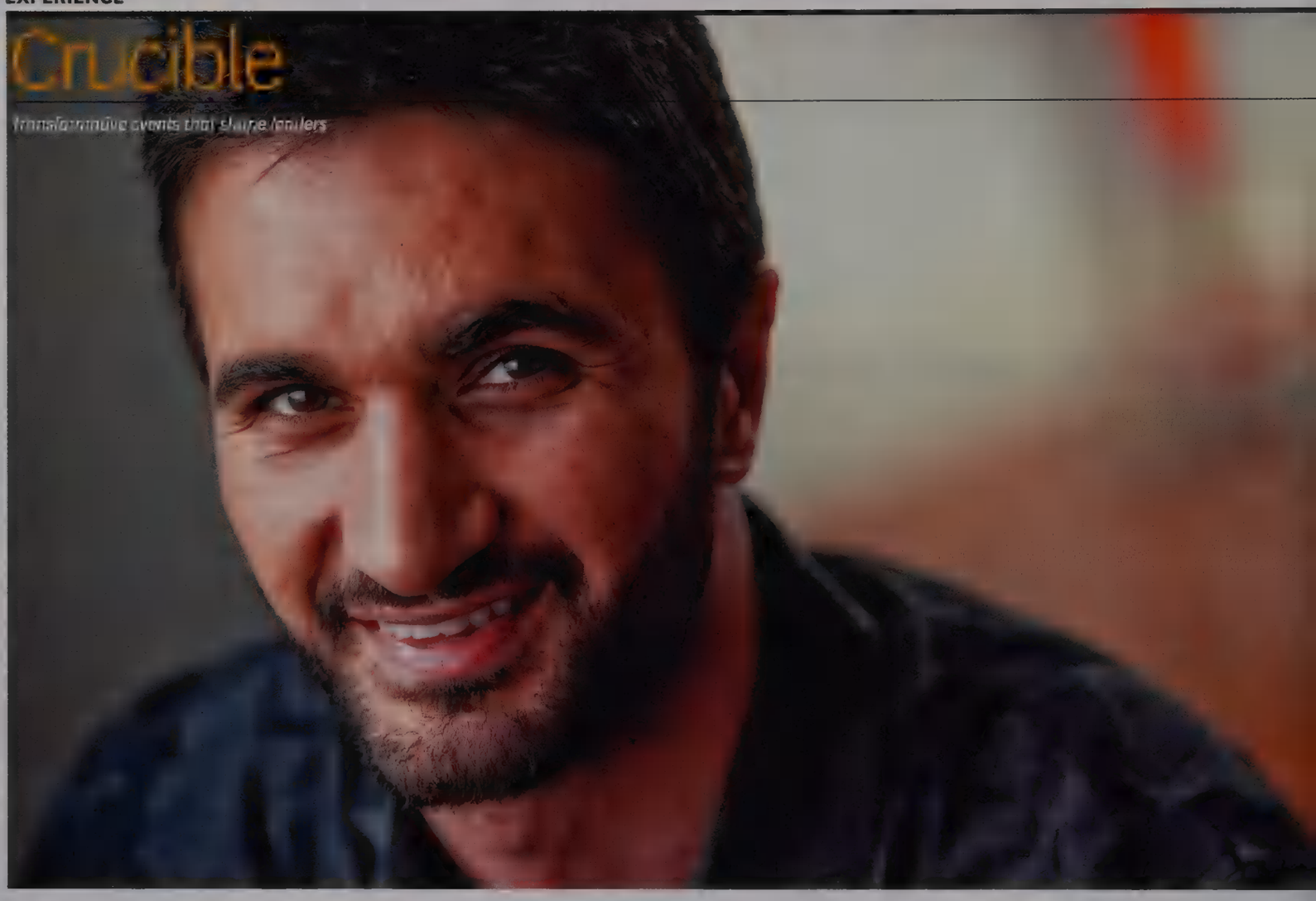
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How a CEO's Injury Helped Him Revitalize His Young Firm

by Daniel McGinn

In the spring of 2009 Farbood Nivi and the venture capitalists backing Grockit, his online-education start-up, were locked in a vigorous debate. More than two years after its launch, Grockit had just 15 employees, mostly engineers—and Nivi still served as CEO. "Farb wanted to keep the management team very small," says Mitch Lasky, of Benchmark Capital, an early investor. "The venture guys were arguing for more-aggressive hiring—a layer of VPs and senior managers. I always tell entrepreneurs, 'Try to build enough competence into the layer below you that if you got hit by a car, life would go on.'"

On May 7 of that year Nivi unfortunately had an opportunity to live out that hypothetical. He was riding home on his Vespa scooter from a night at the movies with colleagues when, near the corner of 8th and Mission Streets, in San Francisco's South of Market neighborhood, he was hit by a minivan. The initial diagnosis in the ER was a broken rib, bruises, and lacerations, but a CAT scan showed that Nivi's right kidney was severely damaged. Doctors performed emergency surgery to remove half the kidney and repair the remainder—a process that left Nivi with a 10-inch scar and his company with a leader who was effectively out of commission for months.

It's an unpleasant reality that executive illness is a risk factor for every business.

Even at large companies—including Apple, where Steve Jobs has faced serious illness since 2004, and McDonald's, which had two consecutive CEOs die suddenly in 2004 and 2005—worries about a leadership vacuum or unclear succession lines can rattle investors and employees. For a start-up, however, the uncertainty created when a company founder is incapacitated can be profound. At the smallest companies the business plan may exist mostly in the founder's head; often there's no succession plan at all.

Grockit was able to survive, thanks to some proactive employees and a leader who did his best to stay engaged during his recovery. In fact, Nivi says, the experience has in some ways made him a better manager. Although everyone involved acknowledges that the scooter accident was a serious setback in the young company's life, it provided a valuable lesson about how to carry on when a CEO is temporarily sidelined.

Nivi, who is 34, graduated from the University of Michigan with a degree in psychology before embarking on a decade-long career in teacher training and curriculum development at Princeton Review and Kaplan. While working for those established education companies, he began to conceive a better way to provide tutoring—one less reliant on a teacher to disseminate knowledge. He envisioned a model with more peer-to-peer instruction, an idea that led to the creation of Grockit's core product, a social game that teaches students math, English, and other subjects. By the time of the accident, Nivi and his team of product-focused engineers had developed a strong beta version of the software, but the firm had little revenue and the product launch was progressing slowly—the company hadn't even hired a marketing team.

David Marino, a close friend and Grockit's director of operations, visited Nivi in the hospital and found him covered with cuts, receiving powerful painkillers through an IV, and taking deep breaths. "He was in survival mode," Marino says. That hospitalization lasted a week; Nivi had a laptop with him but checked in at the office only intermittently. Once at home, however, he turned his bed into a command center equipped with two laptops, an iPhone, and a BlackBerry. His message to employees was "I'm available, contact me—whatever you need." Observers commend Nivi for keeping the team focused despite his absence. "He continued to essentially run the company from his bed in an unbelievable way," says Lasky, the venture capitalist. He returned to the office in late June, but he still wasn't himself. In mid-August his doctors discovered he had adhesions, a postsurgical condition that can lead to serious intestinal obstructions. He entered the hospital for a second surgery and a two-week stay.

Emergency surgery left Nivi with a 10-inch scar and his company effectively without a leader.

Not everything went smoothly during his absence. "Some people took advantage of the situation, not showing up until much later in the day," says Marino, who assumed control of the office. "People started missing Fridays. The environment definitely changed. The mood changed. We'd lost our leader." Three of Grockit's 15 employees quit in the months after the accident. Nivi cites the work of the late Russell Ackoff, a Wharton professor emeritus who wrote about leadership as an aesthetic function. "A leader is a cheerleader for a vision," he says, "and people need to be cheered into the worldview we're trying to get them into." When the leader is absent, that cheering stops, and problems mount.

By the time Nivi returned to work full-time, in December, his outlook had changed. "We spent a lot of time reflecting on what the accident taught him about himself," says Jeff Fagnan, a partner at Atlas Venture and a close friend. Before the accident Nivi had obsessed over Grockit's burn rate, trying to minimize payroll to make the venture capital funds he'd received last longer. After the accident he concluded that was the wrong approach. "One of the things that came out is that he needed help in growing this business," Fagnan says. Nivi concluded that by hiring managers who were better than he was at certain functions, Grockit would improve its chances of success. As he recovered, Atlas Venture decided to invest $4 million in the company, bringing the total capital raised to $17 million; this enabled Nivi to hire a chief marketing officer and a chief business development and strategy officer. In September 2010 Roy Gilbert, a veteran Google manager, came aboard as CEO. Today the business has 20 employees, and Nivi says both revenues and users are increasing each month. He now serves as president and chief product officer.

Nivi believes that the accident changed his outlook in another key way: He feels far more decisive. "I'm quicker to move on things," he says, "whether it's a bold new initiative or removing some situation in the company that's not working out—to not let anything that needs to change go unchanged."

Health problems for the CEO aren't typically a risk that concerns the stakeholders of a new company. "Most of the time, we're investing in a young founder who's full of life, full of energy, taking on the world," Fagnan says. Grockit managed to come through the unexpected crisis and may even have gained strength in the process—by drawing the remaining members of the original team closer, forcing Nivi to accelerate hiring, and giving him a better perspective and focus.

"My understanding of the priorities of the organization has been made crystal clear," Nivi says. That wisdom was hard-won, as signified by the long scar on his torso.

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Daniel McGinn is a senior editor at *Harvard Business Review*.

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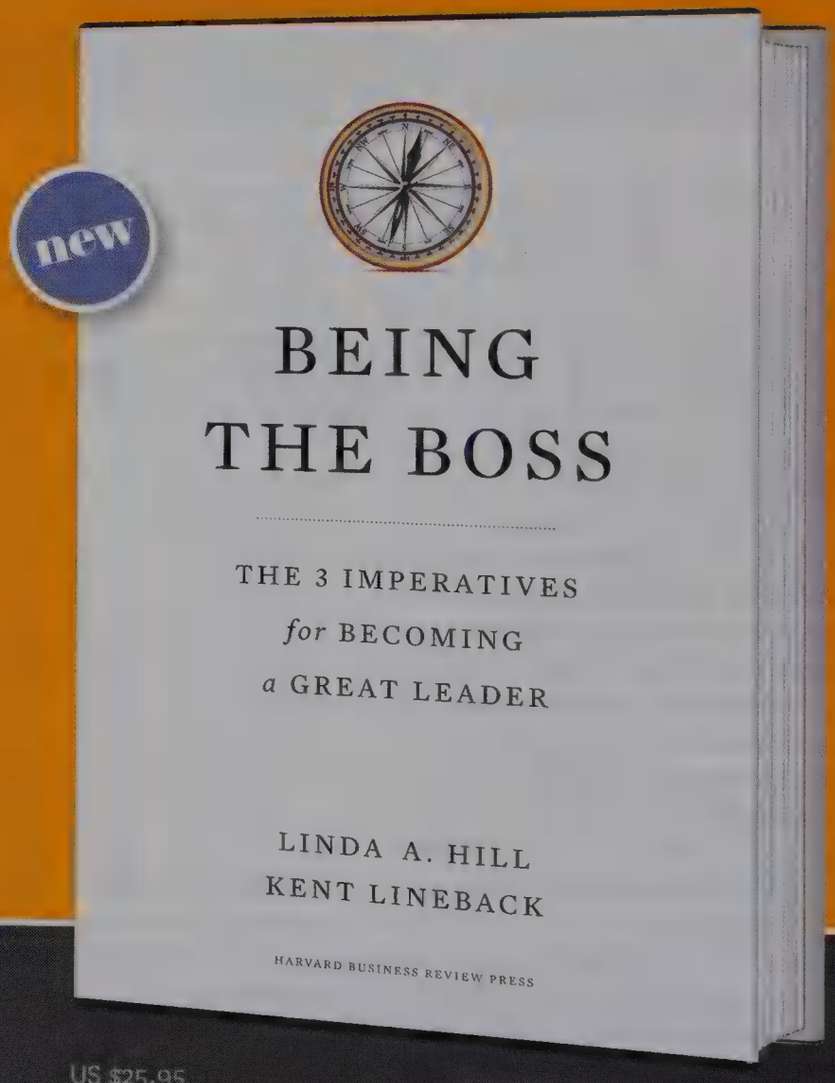
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The Experts



T. Forcht Dagi, MD, Queen's University Belfast, the Harvard–MIT Division of Health Sciences and Technology, and HLM Venture Partners



Merle D. Griff, CEO, SarahCare Adult Day Care Centers and Home Care

Gloria Londoño scanned the tables at the Opera restaurant. Victor Serna was sitting at one in the corner, drumming his fingers on the white tablecloth. She caught his eye and gave a small wave. Victor nodded but didn't smile.

This was their third meeting in a month. The first had been at a small cocktail party hosted by mutual friends. She'd mentioned her business, Calidad de Vida, a group of day care centers for the elderly, and he'd peppered her with questions, explaining that he was interested not only as a doctor (he was the leading cardiothoracic surgeon at Madrid's best hospital) but also as a potential investor (he'd unloaded his stocks just before the market collapsed).

Gloria wasn't necessarily looking for new funding, but she was glad to have made the contact. When Victor called her office a few days later, asking for a tour of her flagship center in Madrid, she was intrigued. She took him around the 7,500-square-foot facility the following week and told him even more about the business. After two hours, he asked her to meet him for lunch in a fortnight. She agreed and proceeded to canvass their common contacts to learn more about him.

Victor came from a wealthy family but was also independently rich, from both his thriving medical practice and his investments. Aside from stocks, he dabbled in an activist brand of angel investing, holding large stakes and board seats in several start-up health care businesses, all based in Spain. He had two ex-wives, a 25-year-old girlfriend, and no children. His suits were Gucci, his watch Patek Philipe.

He was looking at the watch as Gloria sat down. "Prompt—that's a good sign," he said. "I was here a few minutes early, so I already ordered us Serrano ham and Rioja. I had two surgeries today, but now I can relax. Have you eaten here before?"

"Yes, once," Gloria said. "It's lovely."

"I come perhaps twice a week. They do a good job." He motioned to a waiter, who hurried over to pour them glasses of sparkling water and then retreated silently. "So, before the food arrives, let's get the business out of the way. As I'm sure you've

HBR's fictionalized case studies present dilemmas faced by leaders in real companies, and offer solutions from experts. This one is based on the HBS Case Study "Vitalia Franchise" (case no. 311035), by Regina E. Herzlinger and Beatriz Muñoz-Seca. It is available at **hbr.org**.

guessed, pending review of your financial statements, I am ready to invest in Calidad de Vida. Three million euros."

Gloria's heart leaped, but her expression remained calm and confident.

"That sort of money should allow you to open 10 new centers next year, not through franchising, as you'd planned, but under your direct ownership and control. In return, I would want a 25% stake, a board seat, a vote on all strategic decisions, and the ability to liquidate my position in five years, should I so choose, through either a public offering or a sale."

Gloria started to respond, but he cut her off. "My lawyers have drafted a contract." He pulled a document from his briefcase and handed it to her. "Take it home. Read it. Let me know by the end of the week." He beckoned to two more waiters standing nearby with a platter of sliced ham and a bottle of wine. "Now let's eat and talk about something else."

Down from Heaven, Back to Earth

Gloria walked briskly from the Opera to the nearby Jardines de Sabatini. She and Victor had chatted casually about everything but business at lunch—if he didn't want to discuss the offer, she certainly wasn't going to reveal how excited she was by pressing the issue. But she couldn't wait to review the contract.

She found a bench and pulled the document out of her purse. It recapped, in legal language, what Victor had told her. His money would allow her to pursue a new, perhaps more comfortable, growth strategy, directly managing 10 new centers rather than franchising them as she'd done with 11 of the 12 existing Calidad de Vida locations. But the price of gaining that control would be ceding some to him—her own stake would fall from 64% to 51%—and he would have more involvement in the business than any one of the friends and family members who had invested with her thus far.

She would need to discuss the offer with her colleagues and her board very soon. But first, she decided to stick to her plan to visit the nearby center after lunch. The director wasn't expecting her, but Gloria liked popping into the franchises unannounced to get an unvarnished view.

She stood outside the building for a moment, peering into the big glass windows at six elderly clients seated around a table in Calidad de Vida's signature green chairs. They were listening intently as an instructor led them through a memory exercise.

> "I don't want to hand control to Señor Serna, but I'm already giving it up to franchisees."

This scene was what she'd envisioned five years before, when she quit her job as an occupational therapist to enroll in a health care management course and, later, business school. Her goal had been to create an alternative to the traditional nursing home, a place where seniors with various disabilities could come for the day and be rehabilitated through individually tailored activities. In different rooms, groups might be doing physical or music therapy. The staff-to-patient ratio was 1 to 6. Hours were flexible. Families were deeply involved in developing treatment programs. And the approach was consistent across all the franchises: The company used proprietary methodology, therapy-management software, electronic patient records, and strict performance protocols to ensure uniformity, although Gloria knew that some centers outperformed others.

"Gloria! So good to see you!" Paola Silva, the always cheerful center director, greeted her as she walked through the door. "I was just on the phone with Jorge telling him to call you," she said, referring to the franchise owner, Jorge Patriño. "We've had four new clients sign up this week, all full-time. Can you believe it's taken us only nine months to get to 35 clients?" That was the break-even target for a new Calidad de Vida franchise, and it typically took a year.

"That's terrific," Gloria said. "I'll walk around, if you don't mind. Are there any family visits I can observe?"

"Yes, Dr. Chavez just sat down with a client and his granddaughter. We can walk in quietly and stand in the back."

"So, Señor Pico, I'm going to say five words. Please repeat them for me: ball, tree, apple, airplane, fish."

"Ball, tree, apple, airplane, fish."

The granddaughter, slightly annoyed, interrupted: "But, as I said, it's not really that kind of memory my mother is talking about, Dr. Chavez. It's things like forgetting to turn off the television, or what he ate for dinner."

"When does this typically happen?"

"I think at all times of day, but I'm not sure. My mother knows, but she's traveling until tomorrow, and I was told you wouldn't be able to meet later this week."

"Well, your mother can always call me, but I honestly don't see any deterioration since your grandfather arrived. Señor Pico, you're in great shape."

Gloria glared at Dr. Chavez. Why on earth couldn't he have scheduled the visit later in the week? And why wasn't he offering to follow up with the daughter directly? One of Calidad de Vida's golden rules was to treat family members as clients, too. Gloria surmised that Dr. Chavez needed another round of training. His style was at odds with the Calidad de Vida methodology. She would call Jorge later that day to discuss this matter. She didn't doubt his commitment to high-quality, holistic care; Jorge had been a star pupil in the most recent training course at headquarters. But he clearly needed further coaching.

Angelic Temptations

Back at Calidad de Vida's corporate offices that afternoon, Gloria asked Daniel Hernandez, her CFO, and Diana Correa, her deputy director, to join her in the company's lone conference room, a windowless space made cheerful by photos of smiling elderly people on the

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walls and the same bright green chairs found in the centers.

"So you know I met with Victor Serna at lunch, and he wants to invest."

"That's great news," Daniel said.

"Well, yes, but there are strings attached." Gloria explained Serna's offer.

"Those are stiff terms, but if we want to pursue the aggressive growth strategy we've talked about, we could use that money," Daniel said. "I know we've had an easy time recruiting franchisees so far, but you never know what's going to happen. In this economic climate, we might get 10 new ones or we might not."

"I wouldn't worry about that," Diana countered. "Right now we have six candidates who look promising and, last time I counted, 35 information requests. We all know the demographics—an estimated 9 million people over 65 in Spain by 2020. And what about the possible master franchises in Portugal and Mexico? Ten won't be a problem."

"Sure, but we could easily have cash-flow problems along the road," Daniel responded. "All the franchises are hitting their performance targets, but we're benefiting only from the entry fees they pay us and from what we charge them for help with recruitment and training. It will take time before those percentage-of-sales royalties start to accrue. Even then, 5% isn't much, relative to what we could make from wholly owned centers. We're talking about 3 million euros."

"Let's talk about control," Gloria said. "I don't want to hand it to Señor Serna, but I'm already giving it up to franchisees. I was at one of our centers today, and a doctor there didn't even come close to following our methods. This business works only if the Calidad de Vida brand stands for high-quality, innovative care—across the board. How can we continue to do that, in as many centers as we ultimately want, without direct oversight? We've talked about consolidation, giving ourselves time to build and improve the business. Wouldn't this allow us to do both at the same time?"

"Perhaps," Diana acknowledged, "but it would take us a lot longer to get our own centers up and running, especially if Señor Serna meddles as much as everyone says he does. That would change the whole tenor of the organization. And would you really be ready in five years to sell the company or take it public?"

"Serna may have a reputation for meddling, but he's certainly a good businessman," Daniel said. "Why would an IPO be so bad? I wouldn't mind cashing in my equity at some point. And Serna's investment would generate publicity for our holistic approach to patient care."

"Do you think Serna might be willing to negotiate, Gloria?" Diana asked.

"It seems to be his terms or nothing. Look, we won't be able to decide this today. Let's all go home and think about it."

A FEW HOURS LATER, Gloria locked the office and looked down the street, where she could see the illuminated green logo of her flagship center. It was 7:30, so the last clients would be leaving for the night. She pulled a small card out of her purse, the same one that every Calidad de Vida employee carried. On it were listed operational rules and four core values: honesty (speak clearly but with respect), enthusiasm (those who don't believe don't belong), transparency (information is available to everyone), and a search for the common good (put yourself in the client's shoes). Could she uphold those values if she took Victor Serna's money?

Regina E. Herzlinger is the Nancy R. McPherson Professor of Business Administration at Harvard Business School. **Beatriz Muñoz-Seca** is a professor of production, technology, and operations management at IESE Business School, University of Navarra.

Should Gloria accept the angel investment?

See commentaries on the next page.

Harvard Business Review

Tools for Effective Communication

At the heart of any business transaction is communication. But not all communications result in positive actions, and new technologies have changed some of the rules for effective communications.

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The Experts Respond



T. Forcht Dagi, MD, Queen's University Belfast, the Harvard–MIT Division of Health Sciences and Technology, and HLM Venture Partners

GLORIA HAS good reason to accept Victor's offer. She envisions 10 additional Calidad de Vida facilities over the next year in Spain and, eventually, abroad. Her company, however, is capital-constrained. She owns only one of 12 existing centers; the 11 franchised locations provide just 5% in royalties. Finding franchisees has been easy so far, but the franchising model may become less dependable in a dour economic climate. Fund-raising may be equally difficult.

Victor has offered €3 million for a 25% ownership stake and, thus, a post-investment valuation of €12 million. His terms outline typical protective provisions for a minority investor: a board seat, a vote on strategic decisions, and an option to obtain liquidity after five years. Although Gloria's stake would drop from 64% to 51%, she would retain majority ownership and, upon closing, the value of her holdings would increase by 11%, from €5.5 million to €6.1 million. Even if the margins were only slightly better than the royalty percentage, contribution to corporate from each facility would increase with a network of wholly owned centers.

Gloria's entrepreneurial ambitions are exciting. Nevertheless, establishing and growing 10 corporate-owned facilities within a year won't be easy. Gloria has no experience scaling at this pace and to this level. Each facility typically requires a year to break even. She needs to staff her facilities with trained individuals who subscribe to the company's values and innovative approach to elder care. In addition, she will need to intensify marketing efforts to scale recruitment and retention of clients, particularly during recessionary periods.

Gloria is building a brand on strict performance standards that demand intense engagement, high-touch holistic care, and customized service. The use of proprietary technology may help fulfill the brand promise and improve efficiencies of scale, but it cannot overcome requirements for adequate cash flow and financial discipline. Moreover, the need for additional investment during economic slowdowns cannot be dismissed, and capital reserves will matter even more if and when Gloria opts to build internationally.

Victor brings important intangibles to the table, including reputation and connections, which are highly valued in conservative European societies. Gloria may hesitate to change the board's composition, but Victor's broader business experience could prove very useful. A well-positioned investor, furthermore, can facilitate both access to additional capital and successful exits.

> Victor Serna's offer is a heaven-sent opportunity.

Victor says that his terms are not negotiable, but they in fact establish only the four corners of the contract. For the sake of consistency with her principles and her mission—and as part of a due diligence process concerning an offer from an angel investor—Gloria should explore with Victor how closely their values, interests, and methods overlap. She may find less to fear than she imagines—and reasonable ways to resolve material differences.

Victor offers necessary, advantaged, and virtually effortless capital from a single, well-qualified source. This investment would allow Gloria to focus on running and expanding her business rather than on fund-raising. The offer is, quite simply, a heaven-sent opportunity.



WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

GLORIA HAS a growing, profitable business, and the market for it seems to be improving. She is in a great position, so if Victor is unwilling to negotiate, she should refuse his offer. He's not the type of person she'd enjoy working with.

Derek Pearson, *interactive director, Creative B'stro*

GLORIA'S BUSINESS model is about helping ordinary people—specifically, senior citizens. Companies like hers cannot be governed by committees, and that's what would happen if it accepted short-term investors such as Señor Serna.

Andrés López Josenge, *founder and principal, Direction*

GLORIA MUST decide whether Victor's objectives match hers. Franchisees can be encouraged to maintain standards through incentives or penalties. It's not as easy to control a wayward investor; if she and Victor clash, Gloria's dream could become a nightmare.

James Francis, *cofounder, Reallifer unway.com*

GLORIA SHOULD accept the angel investment. She would still retain majority ownership, and having more owned locations would help solidify consistency in policies. But she must also retain her authority to decide whether the organization is privately sold or taken public.

Daniel Pierson, *student, Worcester Polytechnic Institute*

HBR case studies appear at **hbr.org** prior to publication here.



Merle D. Griff, CEO, SarahCare Adult Day Care Centers and Home Care

VICTOR'S OFFER of €3 million is exciting news for Gloria. But as someone who is in the process of seeking investors to fund the expansion of my company, I would advise her to proceed cautiously.

Gloria will need to examine the business and legal implications of Victor's proposed deal, particularly with respect to the existing franchisee relationships. She must also evaluate whether the members of her staff have sufficient resources and an adequate infrastructure at their disposal to support expansion while still executing current operations effectively. Finally, Gloria will have to develop a strategic vision for collaboration between the wholly owned centers and the franchise locations, with the aim of meeting the company's long-term financial goals.

Entering into a business relationship in which red flags are apparent from the outset is never advisable. Victor's behavior toward Gloria at their lunch meeting reveals that he's accustomed to being a dominant force. His aggressive personality is not, on its own, a reason to discount him, but Gloria should make sure that her practical goals and her values align with Victor's before moving forward with him. Some key considerations include the timeline for opening the new centers, overall performance targets, and

Gloria should make sure that her practical goals align with Victor's.

the consequences if those targets are not met.

Gloria and her chief financial officer may assume that Victor's value system matches their corporate philosophy because Victor is a physician. But he already seems to be disregarding one of Calidad de Vida's most important tenets—transparency—by refusing to negotiate the terms of his offer and by dictating a deadline without a clear rationale for it.

Other potential investors will share Gloria's vision.

It's not unreasonable to suspect, for example, that Victor would respond differently than Gloria did to the interaction between Dr. Chavez and Señor Pico's granddaughter at the flagship care center. Would Victor approve of Gloria's instinct to intervene between a doctor and his patient, or would he instead support his fellow physician by default?

This seemingly simple, straightforward proposal from an angel investor actually raises complex questions about the future direction of Gloria's company. Gloria should consult with her lawyers, board members, and management team—and then invite Victor in for another, more comprehensive discussion on her turf. The force of his personality might not be as strong in that context.

If Victor turns out to be unwilling to establish a process and a timeline that suit all the stakeholders at Calidad de Vida, Gloria should just walk away from the offer. Other potential investors will be more compatible with her personally and will share her vision. Without that type of bond, success will not be possible.

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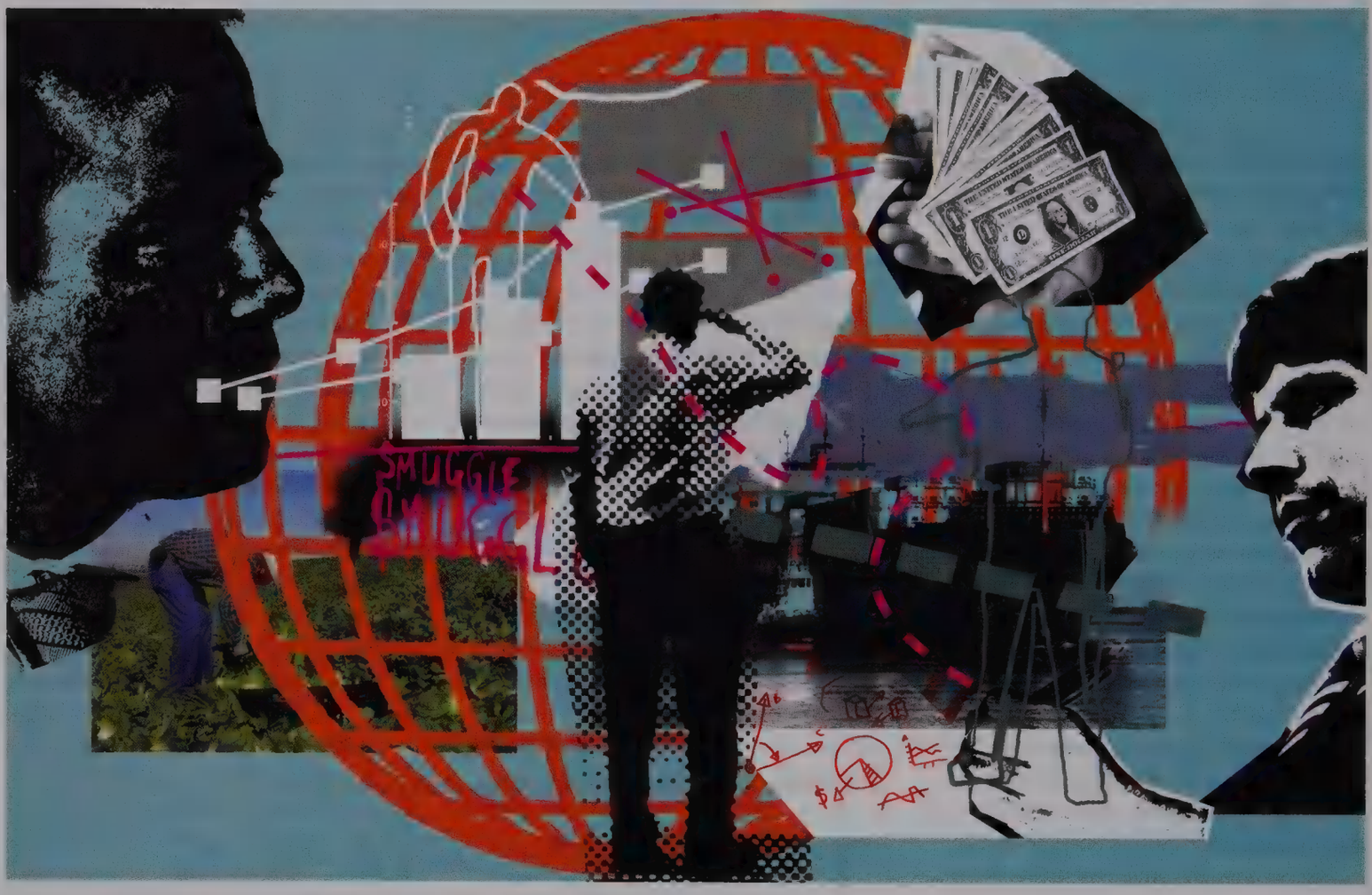
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The Ties That Bind

Free trade, cocaine, pricing: Three new books explore our international connections. *by Tim Sullivan*

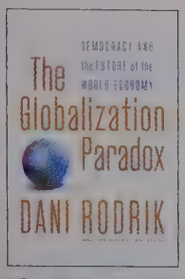
Who would have thought that an academic's theories about globalization would be illuminated by a journalist's book about how to smuggle cocaine? The academic in question is Dani Rodrik, a Turkish-born and Princeton-educated economist at Harvard's John F. Kennedy School of Government. Rodrik is well known to those who have followed debates about trade liberalization over the past 15 years. His voice is sometimes a lonely one in the wilderness of modern economics, since, unlike many of his brethren, he's not a cheerleader for free trade. Instead, in his most recent book, *The Globalization Paradox: Democracy and the Future of the World Economy* (W.W. Norton & Company, 2011), Rodrik advocates for what he calls a better, safer, and healthier economic globalization, acknowledging what is self-evident to many other, harsher critics: that free trade does not necessarily lift all boats—at least not at the same time and not necessarily in a way that satisfies nations or their citizens.

The book about smuggling cocaine, *I Am the Market: How to Smuggle Cocaine by the Ton, in Five Easy Lessons* (Faber and Faber, 2011), by Italian journalist Luca Rastello—ostensibly told in the voice of a master smuggler he calls "Mr. Market"—illustrates a world in which a popular product, grown productively in only one geographic region and in demand everywhere, is banned from legal trade. David Ricardo, the father of the idea of "comparative advantage," would shudder. Yet massive amounts of the white powder are shipped around the world not only by the gram in suitcase compartments and couriers' stomachs but by the kilo, hidden in slabs of marble and wood, impregnated in cloth, and disguised as buttons. The illegal yet highly lucrative drug trade piggybacks on the legal, global free-trade network.

Rodrik isn't so concerned with piggybacking smugglers. Rather, *The Globalization Paradox* boils down to one basic idea: that in the triangular relationship among national sovereignty, democracy, and eco-

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The Globalization Paradox: Democracy and the Future Of the World Economy
Dani Rodrik
W.W. Norton & Company, 2011



I Am the Market: How to Smuggle Cocaine by the Ton, In Five Easy Lessons
Luca Rastello
Faber and Faber, 2011



The Price of Everything: Solving the Mystery of Why We Pay What We Do
Eduardo Porter
Portfolio, 2011

nomic integration, something's gotta give. But what should give, and how, for any particular country—and for the global system as a whole—is really the question. As in any such complicated arrangement, the devil's in the details—details that Rodrik would like to see in the hands of individual countries, obligated to what he calls a "thin layer of simple, transparent, and commonsense traffic rules."

Rastello's cocaine tales may seem far from Rodrik's theories, but in the world of the smugglers, we can readily see the trade-offs to which the professor alludes. The countries that are home to cocaine producers give up some degree of self-determination to the international community in an effort to curb growers; coca farmers, encouraged to plant officially sanctioned options of rice or other grains, lose money; drug pushers use their cash to control national governments, or at least the officials of those governments. Something has indeed given.

Now, I'm not advocating the legalization of the international drug trade, and I don't imagine Rodrik would either. (In fact, I don't think even Rastello's Mr. Market would—there's too much money to be made in keeping it illegal.) But it's easy to see how Rodrik's version of globalization would go a long way toward creating a better system of getting nearly any product around the world—and, equally, how, if taken too far, a world awash in restraints to trade could fail us all.

Rodrik details what could be the most sensible way forward for trade as we struggle to push through our global financial crisis, a period already beset by basic fears cloaked in isms: nationalism, protectionism, and a peculiarly American brand of contemporary Know-Nothingism. Still, sailing along at 30,000 feet, giving us a macro view of how the world should work, *The Globalization Paradox* is not much fun, despite attention to the long history of globalization and a fine eye for evocative and illustrative stories.

I Am the Market has the opposite problem. It's down in the weeds and nothing but fun. It could have been a powerful indictment of drug interdiction and the war on drugs. Instead, it just offers war stories, with the occasional side trip into frightening international prisons to meet Mr. Market's associates.

> "The key to capitalism's durability lies in its almost infinite malleability."
> Dani Rodrik, *The Globalization Paradox*

If you want a book on our global connections that's both entertaining and important, turn to Eduardo Porter's *The Price of Everything: Solving the Mystery of Why We Pay What We Do* (Portfolio, 2011). (Disclosure: I spent some time with Porter discussing the ideas that led to his book; Rodrik, and cocaine, I know only in passing.) Porter, a member of the *New York Times'* editorial board, introduces a prosaic yet surprisingly vital lens for examining our connected world: prices.

Porter uses prices to highlight the economic component of our choices. This proves a surprisingly fruitful strategy that's only enhanced by the author's first-rate storytelling and muscular prose. Consider his take on the Coyotes, who transport illegal immigrants across the U.S.–Mexican border. When the U.S., as it did recently, increases its enforcement at the border—with the National Guard, Minutemen, walls, and such—the Coyotes' price for smuggling people increases. Clear enough. But the cascade of effects goes well beyond that. Faced with a higher cost, some would-be migrants seek alternative, more dangerous routes across the desert; the number of deaths increases. Americans don't much notice—until the costs of their fruits and vegetables go up for lack of cheap labor in California. How do we value human life and opportunity? By the price of a head of iceberg lettuce.

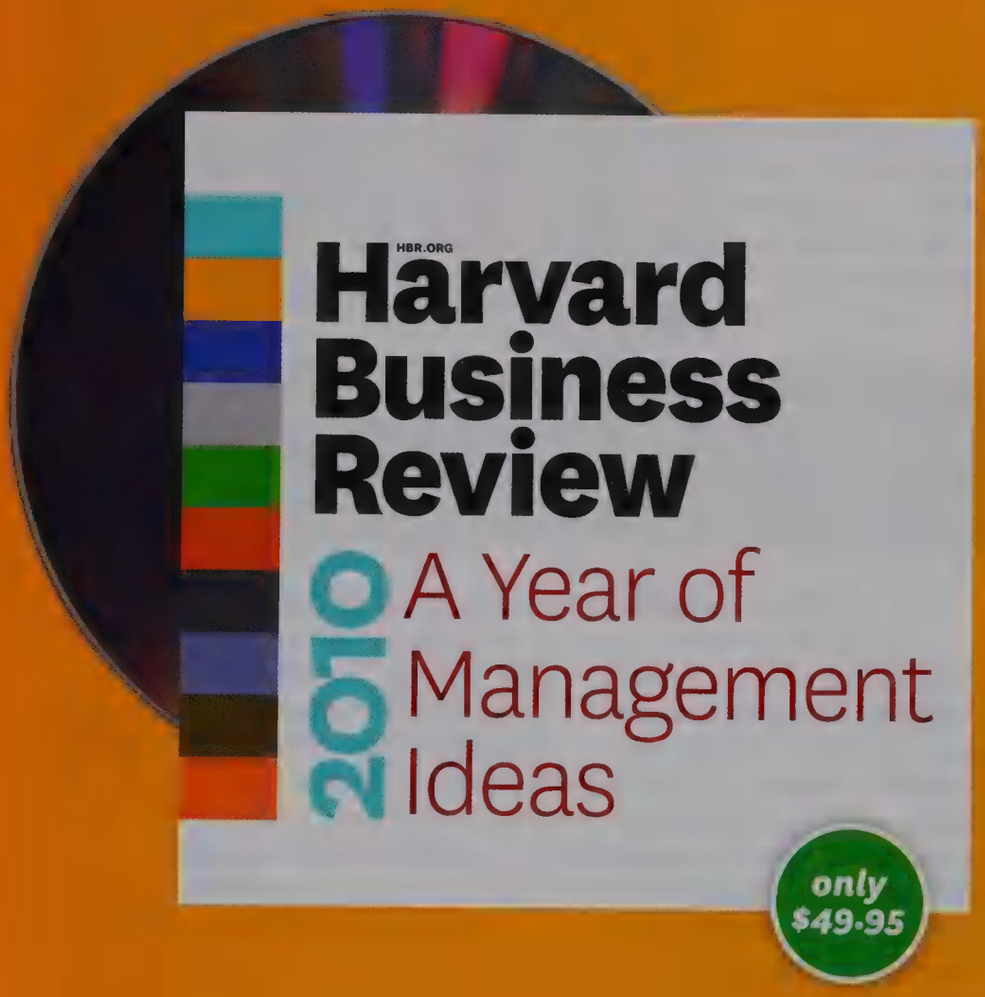
Porter's canvas ranges from the cost of a cup of coffee to the economics of religion to the price of "free"—an appealing riff on the dangers of how we now deal with seemingly costless information. He's at his best when discussing the values we take for granted—how cultural norms change prices, for instance. He struggles, though, with how to address what happens when prices fail and markets go off the rails.

If Rodrik offers an economist's view of the trade networks that bind us together and how they might be managed, and Rastello offers "not a view of the criminal world, but a criminal view of the world"—albeit only a slice of it—Porter offers us a shiny new lens for understanding the relationships around us that we too often fail to see.

Tim Sullivan is an executive editor at Harvard Business Review Press.

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Executive Summaries March 2011

SPOTLIGHT ON LANDING THE NEXT BIG JOB



C-suite jobs look different from the way they did a generation ago, and they'll change even more to keep up with the growing complexity of global business. This article collection describes the skills you'll need to get ahead, whether you're on your way to the top, a lateral assignment overseas, or even a brand-new career.

LEADERSHIP

The New Path to the C-Suite

Boris Groysberg, L. Kevin Kelly, and Bryan MacDonald | page 60

Job requirements at the top of corporations have changed. Companies have come to expect much more from their C-level executives, who need new and different skills to deal with today's business realities. Exactly what abilities do firms want in their leaders—now and in the future? By examining hundreds of job profiles developed by executive-search firm Heidrick & Struggles and interviewing numerous senior managers, the authors have identified some clear trends.

One strikingly consistent finding is that today technical and functional expertise matters less at the top than business acumen and "soft" leadership skills do. Members of senior management now have more in common with their peers than with the people they manage. To thrive at the C-level, you must be a strong communicator, a collaborator, and a strategic thinker. You need a global mind-set and will be expected to offer your CEO deep insights on key business decisions.

This article explores those developments in more detail and explains other findings about the latest requirements in each of seven C-level jobs: CIO, chief marketing and sales officer, CFO, general counsel, chief supply-chain management officer, chief human resources officer, and CEO. It offers a road map for ambitious managers who want to know which skills they should focus on developing in order to rise up the chain of command.

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GLOBAL TALENT

Developing Your Global Know-How

Interviews with Siegfried Russwurm, Luis Hernández, Susan Chambers, and Keumyong Chung | page 70

For up-and-coming executives, an overseas posting has long been a rite of passage, providing opportunities not available in their native countries and experience that can be invaluable to their companies both during the assignment and after their return home. How has the Great Recession affected this formula? HBR spoke with the top human resources executives at four multinationals about how their companies are adapting global assignments to meet the demands of a changing world.

Siegfried Russwurm, of Siemens, talks about the need to recruit workers who will really engage with their new culture—workers with the capacity for truly "international thinking." CEMEX's Luis Hernández discusses personal and professional factors that can make or break an overseas assignment. In the same vein, Keumyong Chung describes measures that Samsung has taken to reduce failures, including preassignment training of various kinds.

Today's economy is prompting cutbacks in some global programs, but the news is not all bad: For example, at Walmart, as Susan Chambers relates, a new emphasis on creative, shorter-term assignments is allowing more people (including more women) to obtain global experience without the major uprooting of a conventional expat assignment. It is also helping them get that experience earlier in their careers—when it can be of maximum benefit to the employee and the company alike.

HBR Reprint R1103D

SELF-MANAGEMENT

Reinventing Your Personal Brand

Dorie Clark | page 78

People reinvent themselves all the time—they may want a new challenge, a new line of work, or a new image among their colleagues. Taking control of your brand can mean the difference between an unfulfilling job and a rewarding career. But how can you persuade others to take the reinvented you seriously? The author presents a five-step approach.

Define your destination. Check out industry trade journals, do informational interviews, even try an internship. See if your company offers shadow programs or sabbaticals. Then build the skills necessary for your new path.

Leverage your points of difference. Use your past experiences and any distinguishing characteristics to your advantage, even if they're not strictly relevant to your work.

Develop a narrative. Learn to communicate exactly how your past fits into the present, and focus on the value your experience brings (rather than on your own interests) when explaining your transition.

Reintroduce yourself. Strategically reeducate your friends and acquaintances, addressing negative perceptions if necessary. Get involved with projects that will showcase your new interests and abilities.

Prove your worth. Use the internet to create and share your content. Associate with the leading organizations in your field. Be consistent and committed as you move forward.

HBR Reprint R1103E

Features

THE BIG IDEA

M&A

The New M&A Playbook

Clayton M. Christensen, Richard Alton, Curtis Rising, and Andrew Waldeck | page 48



Companies spend more than $2 trillion on acquisitions every year, yet the M&A failure rate is between 70% and 90%. Executives can dramatically increase their odds of success, the authors argue, if they understand how to select targets, how much to pay for them, and whether and how to integrate them.

The most common reasons for making an acquisition include holding on to a premium position or cutting costs. But to realize those benefits, the acquirer needs

CEOs often believe that disruptive acquisitions are overpriced.

to achieve economies of scale by absorbing the target's resources into its operations. CEOs, who are often unrealistic about the performance boost from such acquisitions, must be sure not to pay too much for them.

A less-familiar reason for making an acquisition is to fundamentally change a company's growth trajectory. In those deals, the acquirer uses the target's business model as a platform for growth. Because the business models with the most transformative potential are often disruptive, they can be difficult to evaluate, and CEOs often believe that such acquisitions are overpriced. In fact, however, those are the ones that can pay off spectacularly.

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STRATEGY & COMPETITION

Capitalism for the Long Term

Dominic Barton | page 84



As the current financial crisis and the Great Recession begin to ease, executives may be tempted to heave a sigh of relief and return to the comfort of business as usual. But doing so would constitute a serious mistake for their companies—and a grave disservice to capitalism itself, argues Barton, the global managing director of McKinsey & Company.

Rising income inequality, high unemployment, and spiraling budget deficits are fueling public distrust of business, while the shifting balance of power between East and West exacerbates these tensions. But perhaps the biggest danger is that short-term approaches to investing in and managing companies—the "quarterly capitalism" that led to the financial meltdown—still persist. The time is ripe, Barton says, to restore capitalism's founding principles so that it can deliver the sustainable growth the world needs.

Business leaders have a choice: They can initiate the necessary reforms, or they can let the system be reformed for them. They should consider three concrete steps in particular: changing their organization's structure and incentives to focus on the long term; disseminating the perspective that serving the interests of all major stakeholders is compatible with the goal of maximizing corporate value; and putting together more-effective boards, ones with the knowledge and heft to govern like owners.

None of these steps will be easy, Barton acknowledges, but they are all necessary to make capitalism stronger, more resilient, more innovative, and more equitable—a system once again worthy of the public's trust.

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THE HBR INTERVIEW

How eBay Developed A Culture of Experimentation

John Donahoe, CEO of eBay Interviewed by Adi Ignatius | page 92



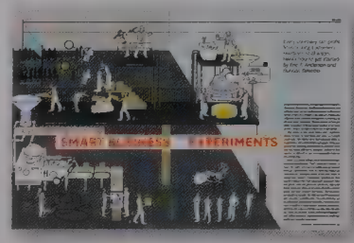
Donahoe took over from Meg Whitman, eBay's celebrated longtime CEO, just under three years ago. The core business was slipping, and eBay's acquisition of Skype had gone wrong. The challenge facing him was how to keep the company strong despite enormous changes in consumer behavior. He talks about capitalizing on mobile technology—eBay's iPhone application, "by far the largest m-commerce application in the world," went from $600 million in volume in 2009 to between $1.5 billion and $2 billion in 2010—and breaking down the barriers between operating online and off-line. The company's acquisitions of RedLaser and Milo, for example, mean that you can walk into a store, scan an item you want with your smartphone, and learn its price both across the web and at merchants within five or 10 miles of you. Because product search on the internet has undercut the power of eBay's auctions, Donahoe is working to make its marketplace indifferent to format. He expects that fixed-price sales will eventually account for 70% of transactions. But that will require re-architecting almost every element of the business system.

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MARKETING

A Step-by-Step Guide to Smart Business Experiments

Eric T. Anderson and Duncan Simester | page 98



The power of analytics in decision making is well understood, but few companies have what it takes to successfully implement a complex analytics program. Most firms will get greater value from learning to do something simpler: basic business experiments.

Managers need to become adept at routinely using techniques employed by scientists and medical researchers. Specifically, they need to embrace the "test and learn" approach: Take one action with one group of customers, a different action (or no action at all) with a control group of customers, and then compare the results. The feedback from even a handful of experiments can yield immediate and dramatic improvements.

In this article, the authors provide a step-by-step guide to conducting business experiments. They look at organizational obstacles to success and outline seven rules to follow.

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How I Did It

Managing Yourself

BACKGROUND

The CEO of Aramex on Turning a Failed Sale Into a Huge Opportunity

Fadi Ghandour | page 43



In 1984 the express delivery company Aramex had launched several small offices in the Middle East, hoping to become the first courier company based in that region. Money was tight, and cofounder and CEO Ghandour describes Aramex in those days as a scrappy, hand-to-mouth business. Global courier companies shied away from the Middle East, in part because there was little market demand for their services, and in part because civil wars and complex political relationships presented enormous logistical and bureaucratic challenges. Often the local postal authorities had a virtual monopoly on deliveries.

In this context Aramex approached the Seattle-based Airborne Express, a respected logistics company, offering to sell a 50% stake for $100,000. Airborne turned down the offer but promised to send some regional business Aramex's way. That gave Aramex the credibility to approach other leading couriers; by 1987 FedEx was also a client.

Over the next two decades, the start-up took full advantage of Airborne's experience, technology, and global reach to learn and grow. It became part of Airborne's global alliance of regional courier companies, and access to Airborne's package-tracking technology gave Aramex an enormous competitive advantage at a very low cost. In 1996 Airborne acquired 9% of Aramex for $2 million, and the following year Aramex became the first Arab company to trade on the NASDAQ.

HBR Reprint R1103A

Zoom In, Zoom Out

Rosabeth Moss Kanter | page 112



Zoom buttons on digital devices let us examine images from many viewpoints. They also provide an apt metaphor for modes of strategic thinking. Some people prefer to see things up close, others from afar. Both perspectives have virtues. But they should not be fixed positions, says Harvard Business School's Kanter. To get a complete picture, leaders need to zoom in and zoom out.

A close-in perspective is often found in relationship-intensive settings. It brings details into sharp focus and makes opportunities look large and compelling. But it can have significant downsides. Leaders who prefer to zoom in tend to create policies and systems that depend too much on politics and favors. They can focus too closely on personal status and on turf protection. And they often miss the big picture. When leaders zoom out, they can see events in context and as examples of general trends. They are able to make decisions based on principles. Yet a far-out perspective also has traps. Leaders can be so high above the fray that they don't recognize emerging threats. Having zoomed out to examine all possible routes, they may fail to notice when the moment is right for action on one path. They may also seem too remote and aloof to their staffs.

The best leaders can zoom in to examine problems and then zoom out to look for patterns and causes. They don't divide the world into extremes—idiosyncratic or structural, situational or strategic, emotional or contextual. The point is not to choose one over the other but to learn to move across a continuum of perspectives.

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THE GLOBE

EMERGING MARKETS

Is the Bottom of the Pyramid Really for You?

Ashish Karamchandani, Mike Kubzansky, and Nishant Lalwani | page 107



If your company is intrigued by the opportunities at the bottom of the pyramid but is hesitant to plunge in, it's not alone: Despite the immensity of the markets and the volume of the hype, few multinational firms have built sizable businesses serving consumers or producers who survive on just a few dollars a day. The reason, say Karamchandani, Kubzansky, and Lalwani, is that it's far more difficult than many global corporations realized to get prices low enough to attract consumers and to manage distributed low-income producers. The authors, from Monitor Group, report on the results of a study of 700 market-based initiatives for social change in India and Africa.

The obstacles to doing business at the bottom of the pyramid are significant: uncertain customer cash flow, difficulty gauging demand, distribution challenges, disaggregated providers, and undeveloped business ecosystems. Using examples from many diverse sectors—including microfinance, housing, insurance, and water purification—the authors explore innovative ways to surmount those obstacles and serve the world's poor.

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Life's Work

To read the extended interview, go to **hbr.org/foster**.

Norman Foster

gained fame in the early 1970s as the architect of the Willis Faber and Dumas headquarters, in Ipswich, England—an eco-friendly, open-plan building that was radical for its time. He has since built more than 250 works, from the Swiss Re (Gherkin) tower in London to the Beijing airport; won many of the world's top architectural prizes; and been appointed a British knight and life peer. The founder and chairman of Foster + Partners, he oversees 15 offices with 1,000 employees working on projects in 40 countries. *Interviewed by Alison Beard*



HBR: Why did you become an architect?

Foster: Working in Manchester when I was younger, I spent every spare minute wandering around buildings in the city. I wasn't consciously thinking, "One day I am going to be an architect; therefore I should be doing this." I was just drawn to them—Barton Arcade, for instance, or the Daily Express building. Travel and the lessons from studying buildings and cities are as important to me now as they were when I was at architecture school. In that sense I am still a student.

Why do you think the Willis Faber and Dumas project was so well received?

Perhaps because the design supported the ethos of the firm. Although Willis had 2,100 employees, it was like a family business. The directors knew many of the staff by their Christian names, and the company had a relaxed management structure and an open-door policy, which encouraged communication at all levels. The use of escalators in a three-story structure, the central atrium, and the social dimension—the swimming pool, the rooftop garden and restaurant—were all conceived in a spirit of democratizing the workplace and encouraging this community. It was also a celebratory building, in contrast to the downbeat mood of the 1970s in Britain.

What makes workplace design so important?

OK, let's put issues of architecture and emotion to one side. You want to talk business. A workplace that is a good place to be attracts people to stay, and that translates directly into improved productivity and material reward. It can also break down barriers. For example, we've challenged stereotypes about white-collar and blue-collar employees; instead of separating them, we've brought them together.

You've said that you hate committees but like teams. Why?

Part of the art of being an architect is to listen. But I also believe in providing strong leadership. Something that is designed by committee, in the end, tends to be compromised. Nothing wins out. The best buildings can be questioned, assailed, revered, but they are always about a vision. At the same time, they are only there because of a dedicated team of people—maybe a tiny core group, or a veritable army spread across continents—who at every turn rejected the shortcut and collectively burned the midnight oil.

How has technology changed your practice?

We've always recognized the value of new technologies—digital modeling, for example—but the computer is just a tool, like the pencil. Technology is a means, not an end. The ends are social and always have been. Important things, like a belief in research, do not change.

Where do you do your best work?

Everywhere. I sketch all the time. In some ways it's a dialogue with myself—the visual equivalent to the notes you might jot down. At the same time, in a meeting I might find that I'm furiously scribbling away while I talk, because I need a drawing to make a point. I see it as a means of communication.

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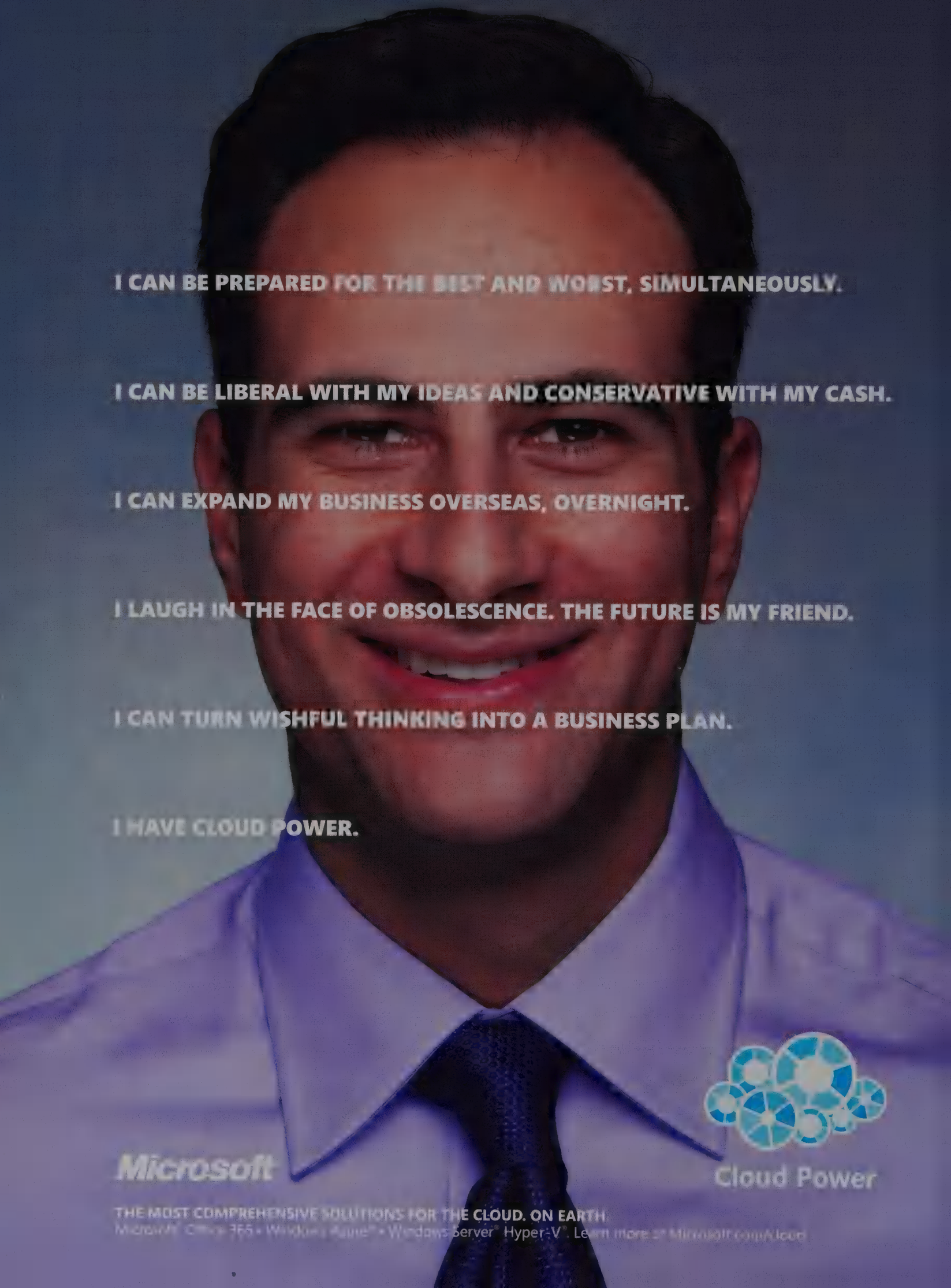
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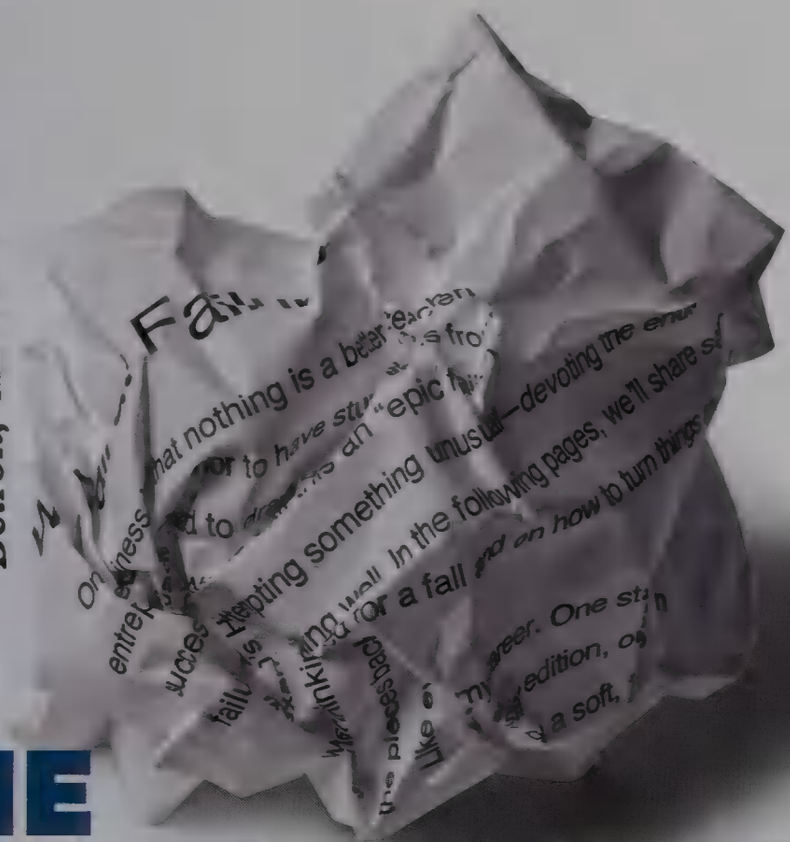
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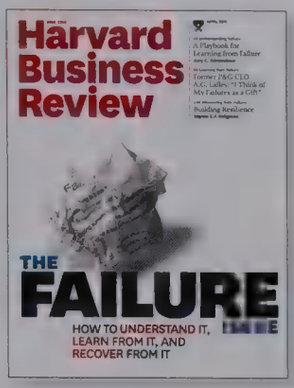
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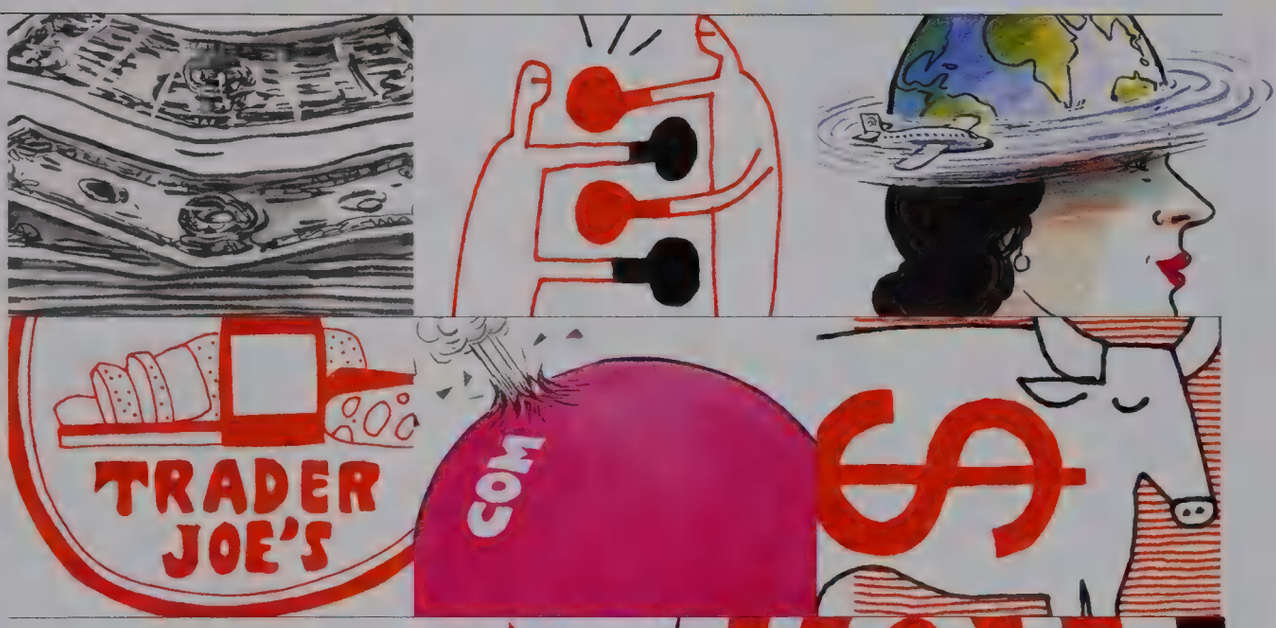
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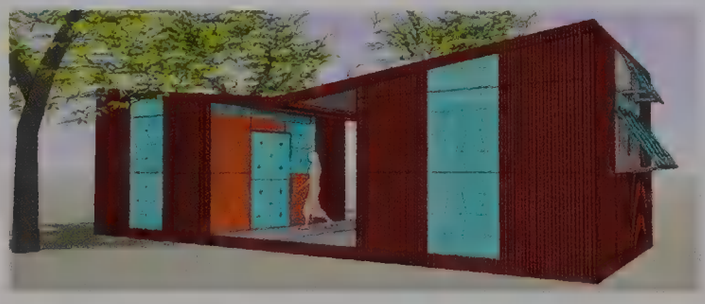
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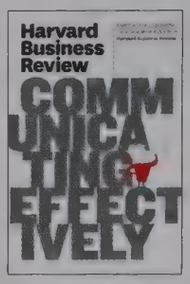
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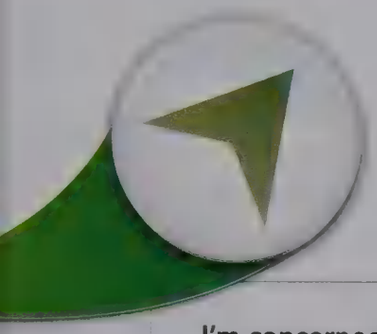
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From the Editor

When We Fail at Failure

One mantra of modern business is that nothing is a better teacher than failure. For some entrepreneurs, it's virtually a badge of honor to have stumbled, even spectacularly, on the way to success. Most of us, however, find it hard to draw useful lessons from our missteps. We tend to fail at failure. (My teenage son and his friends would call this an "epic fail.")

So with this month's HBR, we're attempting something unusual: devoting the entire issue to "the F word"—to examining the art and science of failing well. In the following pages, we'll share some of the smartest thinking on how to tell when you're headed for a fall and how to turn things around—or put the pieces back together.

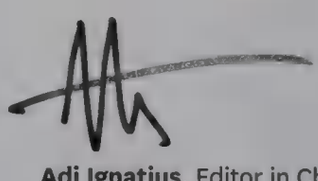


Like everyone else, I've made my share of mistakes in my career. One stands out. In early 2001, when I was in Hong Kong as the editor of *Time* magazine's Asian edition, we ran a story on the city of Jerusalem, which had been produced by our U.S.-based editors. It was meant to be a soft, feel-good article for the spring holidays, a walking tour of a city deemed holy by Christians, Muslims, and Jews alike. The problem was, an illustration in the article depicted the prophet Muhammad. This was before 9/11, when many in the West were still unaware of Islamic sensitivities to images of the prophets. The reaction to the artwork, which many Muslims considered blasphemous, was fierce.

Though we certainly weren't trying to inflame or shock, we set off a wave of anger. Within days of publication, angry protests denouncing *Time* occurred in a few Asian cities. As the senior editorial person in the region, I was even burned in effigy in Kashmir. We had a failure to deal with.

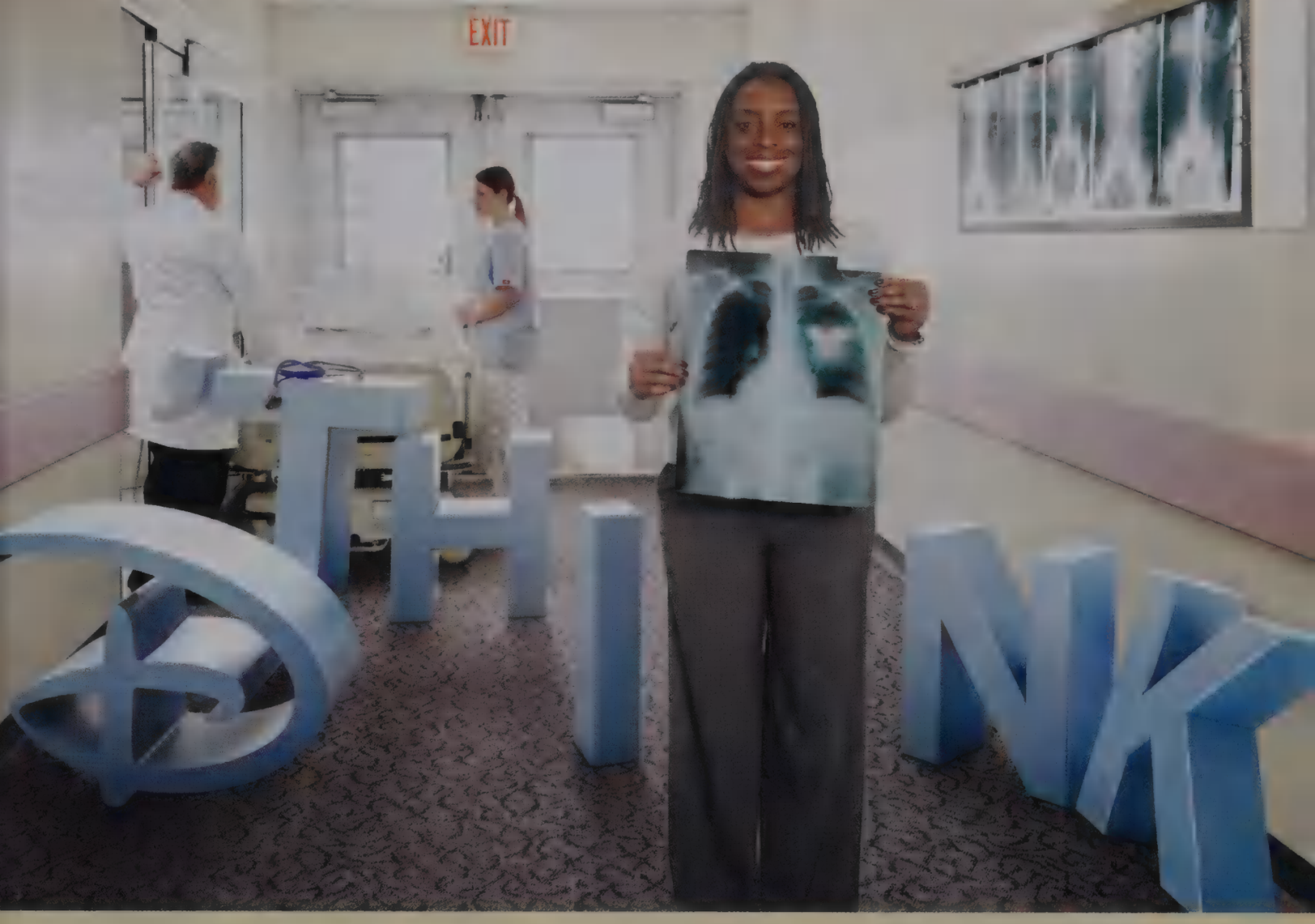
The way out was clear. I issued a full apology. This wasn't a question of free speech or editorial integrity. We had provoked and offended people needlessly, and so it seemed right to express regret. The lessons from the incident were plain: Pay close attention to anything that goes out under your name, because you're responsible for it. And if you didn't set out to pick a fight, it's OK to back down if the other side feels aggrieved.

I hope you enjoy this issue. If you like it, let us know. If not, well, let us know that, too. How else will we learn?



Adi Ignatius, Editor in Chief

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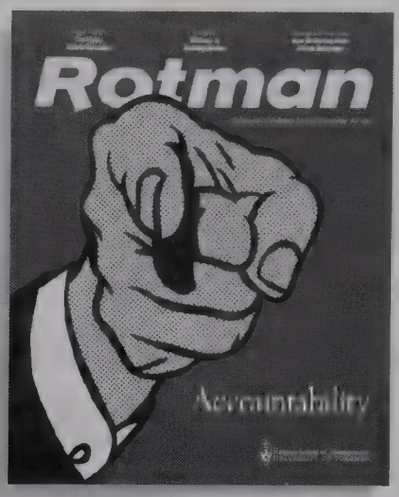
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Creating Shared Value

HBR article by **Michael E. Porter** and **Mark R. Kramer,** January–February 2011

"The capitalist system is under siege," say Porter and Kramer. Business increasingly is viewed as a cause of social and environmental problems, and that has led government officials to set policies that undermine competitiveness. To remedy this, the authors suggest a new purpose for the corporation, one defined by "creating shared value" with society. Moving beyond the idea of trade-offs—profits for social good—shared value "recognizes that societal needs, not just conventional economic needs, define markets."

If you want businesses to make different choices, you must give them reasons to do so. If the idea of shared value moves to the mainstream, it will be because of meaningful regulatory changes. Business leaders have an important role to play in bringing about such political change, but anyone who takes a stand on one side loses friends on the other.

Atilla Habip, partner, The Ripples Group

The authors' theory works with elements of human motivation. However, I can't see it gaining traction. Pride, egocentricity, nationalism, bigotry, racism, and xenophobia are all hurdles here. You have to start with the individual.

Julie Pigdon, business development, Team Management Systems

Shared value is nothing more than 21st-century cheerleading. It will never happen. Business has only one requirement: to make a profit. The rallying cry is for government regulation, but regulation is always a response to a business wrong. Sarbanes-Oxley, for example, was a checklist of the wrongs perpetrated by Enron. Business believes something is wrong only when it gets caught.

Joseph M. Galante, accounting program manager, King's College

How will a generation of businesspeople steeped in discounted-present-value analytics and quarterly earnings come to believe in the power of investment in urban markets or in extending largesse to sectors not directly reflected in income statements? What will the folks at Goldman Sachs make of this? I don't see a definition of "shared value" with anywhere near the cohesion of "shareholder value" or "competitive advantage." The answer may be treating business as yet another social institution, rather than something with a unique and self-defining inner logic. There may be no home-run solution out there; there may simply be another decade or two of coming to grips with the idea that business has to change in a thousand ways. "Creating Shared Value" could be a contribution. But it doesn't feel like a solution, not yet.

Charles H. Green, founder and CEO, Trusted Advisor Associates

Can we permanently replace the term "growth" with "sustainability"? "Growth" implies a mental climate that perpetuates dated, detrimental neoclassical concepts.

Elise Holowicki, office coordinator, Lunchbox LP

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Preparing for the Big Mobile Revolution

HBR Agenda item by **Eric Schmidt,** January–February 2011

Before stepping down as CEO, Schmidt revealed that most of Google's strategic initiatives in 2011 would be mobile—and would include making smartphones accessible to the poor: "We envision literally a billion people getting inexpensive, browser-based touchscreen phones over the next few years."

I have a PhD student working on an ethnographic study of how village farmers in Bangladesh have integrated mobile phones into their lives and work. He found that it is not smartphones they need, but devices that make sense to people who are partially literate in Bengali and less literate in English. They managed to find ways of using the phones to help them, but they used notebooks to store numbers because they couldn't understand the phone's address book. And the one phone with a Bengali interface used a word for "select an option" that means "vote in an election" in Bengali.

Dr. David Newman, former lecturer, Queen's University Management School

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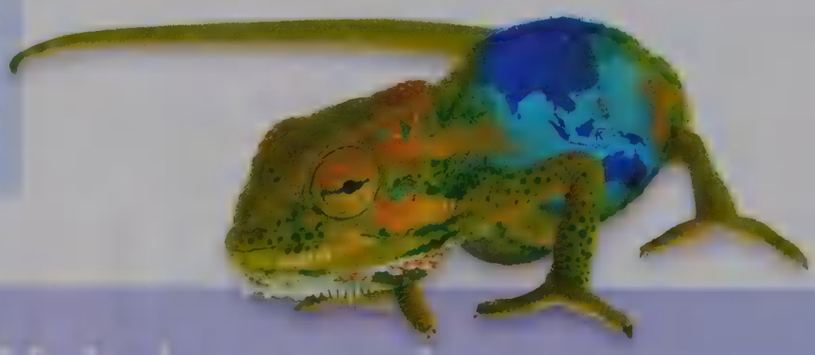
Companies need to engage all players in this new value ecosystem. This requires both a left-brained, economically driven component, which the article describes in detail, and a right-brained, experience-based component, which the article does not address. Venkat Ramaswamy and I described this aspect of value creation in our October 2010 HBR article, "Building the Co-Creative Enterprise." Shared value is the goal. Co-creation is the process to get there.
Francis Gouillart, president, Experience Co-Creation Partnership

Porter responds: *The opportunity for co-creation does not mean that industry structure (the five forces) becomes unimportant. There is always the question of how to divide the pie, however large that pie might be. Shared value offers new ways to collaborate to expand the pie by riveting attention on society's unmet needs. But efforts to create shared value must recognize the hard-nosed reality of market competition, or shared value will go the way of many well-meaning ideas that were never implemented. I would caution against the idea that creating shared value replaces past management thinking. Let us not create a false dichotomy between shared value and the core economic principles of competition, but harness the connection.*

People in developing countries use "trickle down" technologies. We should not oppose this trend but use technology to our advantage. Any translation is better than no translation. I will gladly take smartphones and readily adapt myself to them.
Samir Shah, Mumbai

It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.

—CHARLES DARWIN



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Interaction

The End of the Middle Manager

HBR column by **Lynda Gratton,** January–February 2011

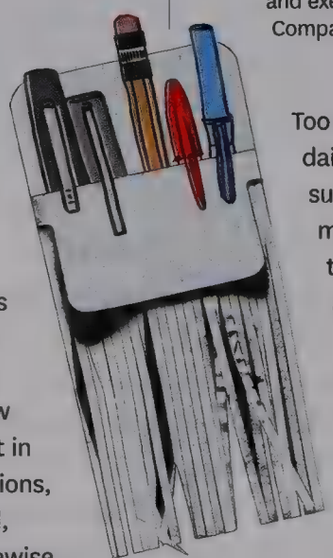
Like the Industrial Revolution before it, the technology revolution is creating seismic shifts in how people work. London Business School professor Gratton asserts that "the classic job of the middle manager will soon disappear" now that "technology itself has become the great general manager." Her research shows that younger workers value a highly skilled "master" who is capable of mentoring instead of "someone who simply keeps track of what they do."

I disagree. As a jack-of-all-trades, the middle manager understands how to leverage multiple sources of information—creating value by acting as a hub in a sea of complexity.

Adam Piotrowski, manager, advanced portfolio development, Stryker

I agree that a "skilled team" doesn't need much management. But to *become* such a team takes a lot of management, the type that the midlevel manager alone is capable of providing.

Ray Kehoe, president, Ray Kehoe Consulting



The idea that middle managers are a vestige of an era predating sophisticated technology is inaccurate. Gratton's narrow definition ignores the fact that in the most successful organizations, managers are part of a nested, adaptive learning system. Likewise, one would be hard-pressed to imagine the military operating with privates and generals alone, absent corporals and sergeants, let alone lieutenants, captains, and majors. For an analogy: Complex body systems have control at the cellular, tissue, organ, and system level. Very little of what we do rises to conscious thought. When it does—such as when a diabetic controls insulin and blood sugar levels—the processing burden can be incredible.

Steven Spear, senior lecturer, MIT Sloan School of Management

Gratton responds: *This is where the idea of deep skills comes in. If you want to manage complex teams, you have to gain their commitment. Much of that will be determined by the extent to which you are seen to be adding value.*

"Keeping track of what others do"? Is that really all (some) managers are doing?

Liliana Panic, management consultant and executive coach, Liliana Panic Company

Too many managers focus on daily minutiae aimed at making sure the employee is following management's preferred path toward results. But results are proof of productivity, and how the employee achieves it shouldn't be your concern as long as it is happening.

Carrie Patrick, social media manager, AAA Colorado

The problem is that companies do not hire managers that are experts at managing, and instead reward individual contributors by promoting them into management positions. This has devalued the role.

Greg Lowe

Managers will transition from being supervisors who monitor work to facilitators who help subordinates realize their full potential.

Deepali Agarwal, area sales manager, Hindustan Unilever Limited

The Worst Job Interview Question

HBR blog post by **Priscilla Claman,** January 2011

We've all heard it: "What's your greatest weakness?" Career coach Claman suggests preparing an answer that's "true, trivial, brief, and not a fault"—for example, saying that you lack a strong local professional network because you are moving to join your fiancé or that you attended an obscure college. But she still believes this uncomfortable question should go out of style.

This is a canned question, but if anyone gave me any of those canned answers I would immediately call him or her on it. The fiancé answer is a good rationale for the job move but hardly a weakness, and certainly not the greatest weakness.

Chris Bird, chief architect, Sabre Airline Solutions

Present your biggest weakness and a strategy to combat it. If someone told me that her undergraduate school was her biggest weakness, I would lose respect for her.

Rebecca Rapple, account manager, Rubicon Marketing Group

If everyone told the truth, no one would get hired.

Phik Li, Sin, English teacher, Kumon Asia & Oceania

This is actually my favorite question, but I change it up a bit: "What are you currently working to improve in yourself?"

Mike Thompson, former senior manager, Windstream Communications

I don't mind asking a potential boss about his greatest weakness, too. After all, the interview is about both people buying into a mutually benefiting relationship.

Bob Ferrer, consultant, Ferrer Creative



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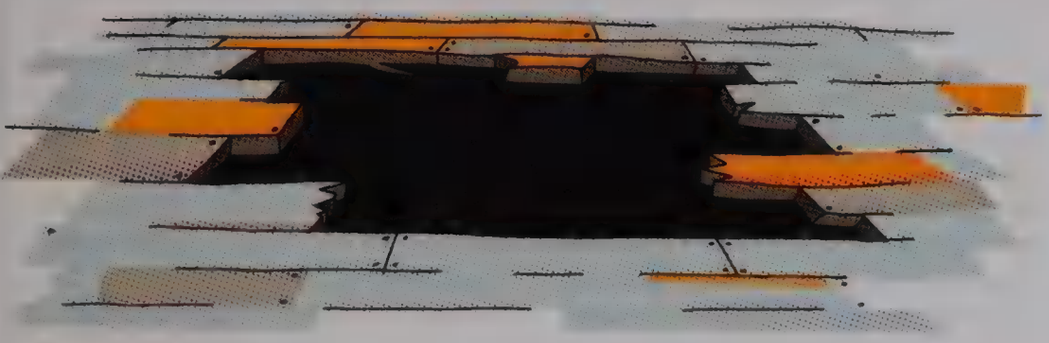
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FIRST

Why Most Product Launches Fail

Getting attention for a new offering is a big challenge. Five causes of flops—and how to avoid them *by Joan Schneider and Julie Hall*



As partners in a firm that specializes in product launches, we regularly get calls from entrepreneurs and brand managers seeking help with their "revolutionary" products. After listening politely, we ask about the research supporting their claims. The classic response? "We haven't done the research yet, but we know anecdotally that it works and is totally safe." We've been fielding these calls for so long that we can often tell from one conversation whether the launch will succeed.

Most won't. According to a leading market research firm, about 75% of consumer packaged goods and retail products fail to earn even $7.5 million during their first year. This is in part because of the intransigence of consumer shopping habits. The consultant Jack Trout has found that American families, on average, repeatedly buy the same 150 items, which constitute as much as 85% of their household needs; it's hard to get something new on the radar. Even P&G routinely whiffs with product rollouts. Less than 3% of new consumer packaged goods exceed first-year sales of $50 million—considered the benchmark of a highly successful launch. And products that start out strong may have trouble sustaining success: We looked at more than 70 top products in the Most Memorable New Product Launch survey (which we help conduct) for the years 2002 through 2008. A dozen of them are already off the market.

Numerous factors can cause new products to fail. (Go to hbr.org/40-reasons for an extensive list.) The biggest problem we've encountered is lack of preparation: Companies are so focused on designing and manufacturing new products that they postpone the hard work of getting ready to market them until too late in the game. Here are five other frequent, and frequently fatal, flaws.

FLAW 1 The company can't support fast growth.

THE LESSON Have a plan to ramp up quickly if the product takes off.

MOSQUITO MAGNET In 2000 we worked with American Biophysics on the launch of its Mosquito Magnet, which uses carbon dioxide to lure mosquitoes into a trap. The timing was perfect: The West Nile virus scare had elevated mosquitoes from irritating nuisances to life-threatening disease carriers.

Mosquito Magnet quickly became one of the top-selling products in the Frontgate catalog and at Home Depot. But American Biophysics proved more adept at killing mosquitoes than at running a fast-growing consumer products company. When it



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Companies are so focused on designing and manufacturing new products that they postpone the hard work of getting ready to market them until too late in the game.

expanded manufacturing from its low-volume Rhode Island facility to a mass-production plant in China, quality dropped. Consumers became angry, and a product that was saving lives almost went off the market. American Biophysics, which had once had $70 million in annual revenue, was sold to Woodstream for the bargain-basement price of $6 million. Mosquito Magnet is making money for Woodstream today, but the shareholders who originally funded the device have little to show for its belated success.

FLAW 2 The product falls short of claims and gets bashed.
THE LESSON Delay your launch until the product is really ready.
MICROSOFT WINDOWS VISTA In 2007, when Microsoft launched Windows Vista, the media and the public had high expectations. So did the company, which allotted $500 million for marketing and predicted that 50% of users would run the premium edition within two years. But the software had so many compatibility and performance problems that even Microsoft's most loyal customers revolted. Vista flopped, and Apple lampooned it in an ad campaign ("I'm a Mac"), causing many consumers to believe that Vista had even more problems than it did.

If Vista were launched today, the outcome might be even worse, owing to the rising popularity of Twitter and YouTube and the prevalence of Facebook "hate" pages. As social media and user-generated reviews proliferate, the power of negative feedback will only increase—making it even more imperative that products be ready before they hit the market.

FLAW 3 The new item exists in "product limbo."
THE LESSON Test the product to make sure its differences will sway buyers.
COCA-COLA C2 For its biggest launch since Diet Coke, Coca-Cola identified a new market: 20- to 40-year-old men who liked the taste of Coke (but not its calories and carbs) and liked the no-calorie aspect of Diet Coke (but not its taste or feminine image). C2, which had half the calories and carbs and all the taste of original Coke, was introduced in 2004 with a $50 million advertising campaign.

However, the budget couldn't overcome the fact that C2's benefits weren't distinctive enough. Men rejected the hybrid drink; they wanted full flavor with no calories or carbs, not half the calories and carbs. And the low-carb trend turned out to be short-lived. (Positioning a product to leverage a fad is a common mistake.)

Why didn't these issues come up before the launch? Sometimes market research is skewed by asking the wrong questions or rendered useless by failing to look objectively at the results. New products can take on a life of their own within an organization, becoming so hyped that there's no turning back. Coca-Cola's management ultimately deemed C2 a failure. Worldwide case volume for all three drinks grew by only 2% in 2004 (and growth in North America was flat), suggesting that C2's few sales came mostly at the expense of Coke and Diet Coke. The company learned from its mistake, though: A year later it launched Coke Zero, a no-calorie, full-flavor product that can be found on shelves—and in men's hands—today.

FLAW 4 The product defines a new category and requires substantial consumer education—but doesn't get it.
THE LESSON If consumers can't quickly grasp how to use your product, it's toast.
FEBREZE SCENTSTORIES In 2004 P&G launched a scent "player" that looked like a CD player and emitted scents (contained on $5.99 discs with names like "Relaxing in the Hammock") every 30 minutes. The company hired the singer Shania Twain for

REMEMBER ANY OF THESE SHORT-LIVED SUCCESSES?

Each year the Most Memorable New Product Launch survey names the best launches. But even brands that make the top 10 aren't guaranteed longevity. These products, launched "successfully" from 2002 to 2008, disappeared within two years.



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One of our biggest misses

When secret agent Maxwell Smart and his boss wanted to have a private chat on the 1960s sitcom *Get Smart*, they hit a button and a transparent "cone of silence" descended from the ceiling. Forty years later, as cell phones led people to gab in restaurants and other public places, Anthony Ferranti saw a need for a real-life silent chamber, both to give callers privacy and to prevent their conversations from annoying those around them. In 2006 he created a prototype Cell Zone, unveiling it at that year's Restaurant Show, where it was a huge hit. He hired our company, Schneider Associates, to publicize the product, which was soon featured in *USA Today* and on NBC's *Today* show.

But despite all the excitement, hardly anyone ordered the $3,500 unit. Restaurants weren't willing to give up the square footage. Nightclubs weren't interested, partly because their clientele was shifting from voice calls to texting. Ferranti tried selling ads on the booths, but that effort fizzled, too. To date he has sold fewer than 300 units (100 of them to college libraries)—and his company has lost more than $650,000. For a small entrepreneur, that's a steep price to pay for failing to understand the market before launching a product.



its launch commercials. This confused consumers, many of whom thought the device involved both music and scents, and the ambiguity caused Scentstories to fail.

When a product is truly revolutionary, celebrity spokespeople may do more harm than good. A strong educational campaign may be a better way to go. The product's features provide the messages to build brand voice, aided by research and development teams, outside experts, and consumers who've tested and love the product.

FLAW 1 The product is revolutionary, but there's no market for it.

THE LESSON Don't gloss over the basic questions "Who will buy this and at what price?"

SEGWAY The buzz spiraled out of control when news of a secret new product code-named Ginger and created by the renowned inventor Dean Kamen leaked to the press nearly 12 months before the product's release. Kamen, it was said, was coming up with nothing less than an alternative to the automobile. When investors and the public learned that the invention was actually a technologically advanced motorized scooter, they were dumbfounded. Ads showing riders who looked like circus performers perching on weird-looking chariots didn't help, nor did the price tag—$5,000. Instead of selling 10,000 machines a week, as Kamen had predicted, the Segway sold about 24,000 in its first five years. Now it sells for far less to police forces, urban tour guides, and warehouse companies, not the general public. If there was ever a product to disprove the axiom "If you build it, they will come," it's the Segway.

SOME OF these problems are more fixable than others. Flaws 1 and 2 are largely matters of timing: If the launches of Mosquito Magnet and Microsoft Vista had been postponed, the manufacturing and quality problems might have been resolved. Even though companies may be wedded to long-established or seasonal launch dates, they would do well to delay if waiting might increase the odds of success. Flaws 3, 4, and 5 are trickier, because they relate more directly to the product itself. Managers must learn to engage the brand team and marketing, sales, advertising, public relations, and web professionals early on, thus gaining valuable feedback that can help steer a launch or, if necessary, abort it. Hearing opposing opinions can be painful—but not as painful as launching a product that's not right for the market or has no market at all.

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Joan Schneider is the president of Schneider Associates; **Julie Hall** is its executive vice president. They are the coauthors of *The New Launch Plan: 152 Tips, Tactics and Trends from the Most Memorable New Products* (BNP Media, 2010).



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The Gift that Keeps on...Getting Lost

Consumers will be unable to redeem some $2.5 billion worth of gift cards this year, mainly because of loss or expiration, according to projections by the **Corporate Executive Board's TowerGroup**. That's a big number, but it's an improvement over 2007, when recipients failed to cash in on $8 billion worth of gift cards—more than 10% of the value of all cards purchased that year. The decrease is due in part to new federal regulations that reduce fees and mandate more-generous expiration dates.

$2.5 BILLION

SERVICE FAILURES *by Jochen Wirtz*

How to Deal with Customer Shakedowns

It's one of the most basic aphorisms of business: The customer is always right. But when companies, especially large ones, try to rectify a service failure and satisfy an aggrieved customer, they face a risk many managers don't think about: becoming a target for opportunists.

In my research, I define opportunistic customers as those who exploit companies' compensation efforts for gain. Examples of this behavior exist in most service industries. One utility company received a claim from a customer for nearly $1,000 for food spoilage after a two-minute power outage. One travel company was asked for a full refund because a vacation hadn't met unrealistically high expectations. One hotel faced off with a guest who insisted on a penthouse suite to compensate for a reservation error that had been immediately resolved.

All these over-the-top demands involved midsize to large companies. Janet McColl-Kennedy, of the University of Queensland, and I analyzed some 500 claims, both reasonable and opportunistic. Only five of the opportunistic claims were directed against small companies, which constituted 40% of our sample.

We think one reason opportunists prey on larger companies involves self-image and shame. Most people don't want to feel like a bad guy—someone who would take advantage of a company that can ill afford a handout.

An opportunistic claim against a big company evokes little shame, because the customer can easily convince herself it won't really harm the company. Still, many opportunists are aware they're doing something wrong. We asked 40 people, "Have you ever asked for a refund or compensation that you thought was too much or unreasonable given the circumstances?" Seventeen admitted having done so within the past six months.

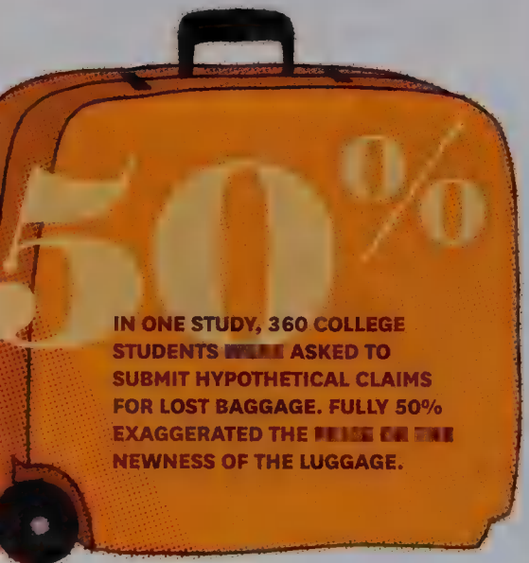
Another reason bigger companies are targeted probably has to do with the perception that because they have deep pockets, they'll be quicker to offer compensation. Although we don't have hard data on payouts, our research indicates that many midsize and large companies are, in fact, so focused on customer satisfaction and repeat patronage that they typically agree to opportunistic claims.

But companies aren't helpless: They can reduce those claims by treating customers justly as soon as something goes wrong. Most people will respond in kind. There are three forms of justice that sway customers after a service glitch: the fairness of the compensation, the convenience of the claims process, and the company's friendliness and level of concern.

And it's the total of a company's efforts in these areas that matters. A company can compensate for smaller payouts with a smooth claims process and a friendly response. Having a manager speak with the customer immediately may help minimize compensation beyond the specific loss. In a study of Taiwanese chain restaurants, Chen-Tsang Tsai, of National Taiwan Normal University, and Ching-Shu Su, of Jinwen University of Science and Technology, found that managerial attention produced the highest levels of customer satisfaction, beating out free food, discounts, coupons, and replacement items.

Finally, any compensation should be offered promptly. Customers who have to negotiate are more likely to make excessive demands—and their satisfaction remains low even after their claims are settled.

HBR Reprint F1104B



Jochen Wirtz is an associate professor at the National University of Singapore's business school.

PHOTOGRAPHY: AP PHOTO/TONY AVELAR

Opportunity doesn't always arrive gift wrapped.



Some thoughts on unlocking potential in today's environment: 1. Innovation is essential, especially if it's disciplined and focused on business outcomes; 2. Out-thinking the competition is useless unless you can out-execute them as well; and 3. This is no time for trial and error; winners get it right the first time. Talk to us to see how we can help you turn potential into tangible performance.

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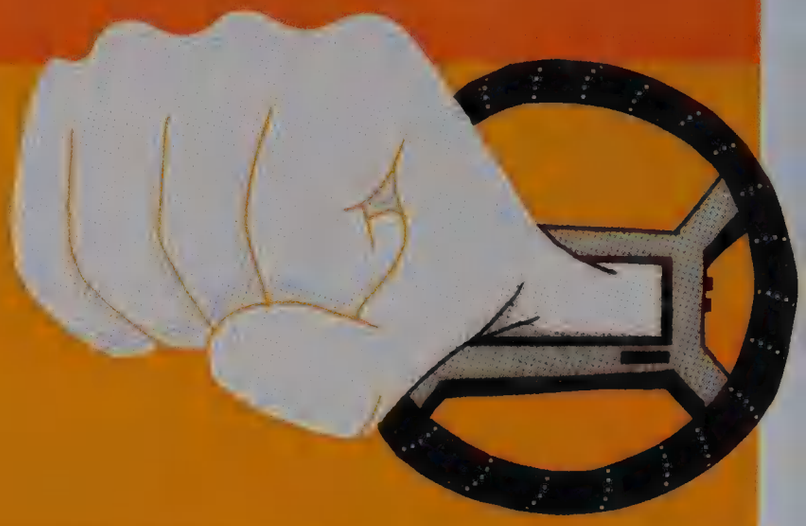
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Research Watch

First, Do No Harm

Knowing there's even a slight chance that a safety device could fail is enough to make consumers reject the device, although the decision puts them at greater risk. In an experiment conducted by **Andrew D. Gershoff**, of the University of Texas at Austin, and **Jonathan J. Koehler**, of Northwestern University School of Law, most subjects indicated that they would avoid using an airbag that had a minuscule chance of harming them. People perceive the potential for failure as a betrayal, the researchers explain, and this emotional response gets in the way of their ability to make rational decisions.



SMALL BUSINESS *by Deniz Ucbasaran, Paul Westhead, and Mike Wright*

Why Serial Entrepreneurs Don't Learn from Failure

Everyone admires serial entrepreneurs for their pluck and persistence, but they pose a big risk for the investors who fund their dreams. Our research shows that instead of learning from mistakes, serial entrepreneurs are just as apt to be overoptimistic after failure as before.

Overoptimism—defined as the tendency to believe that one is more likely than others to experience positive events and less likely to experience negative ones—comes with the start-up territory, of course. Studies have shown that entrepreneurs of all types are more prone to it than the general population.

Although overoptimism is useful in getting a business off the ground, it can also help cause that business to tank. It is associated with a greater tendency to commit to and overinvest in risky projects, to neglect to plan for the unexpected, and to throw good money after bad while postponing the inevitable.

Experiencing failure can temper this surplus of optimism among some entrepreneurs—but not serial entrepreneurs.

In a survey of 576 UK-based entrepreneurs in a variety of industries, conducted through questionnaires that covered successes, failures, and attitudes, we found that those who hold multiple businesses simultaneously—we call them portfolio entrepreneurs—seem able to adjust their expectations according to experience. If they've suffered flops, they're typically more realistic than novice entrepreneurs. Because they learn from their setbacks, they may be especially good candidates for investment.

But serial entrepreneurs, who take on one project at a time, are a different breed. Even if some retain specific lessons about what worked and what didn't, their overoptimism remains undimmed by failure. Others refuse even to look at why things went wrong. "Spending your time thinking about what happened is a ticket to the graveyard," one told us.

208
ABOUT HALF OF THE 576 ENTREPRENEURS WERE REPEAT ENTREPRENEURS

34%
OF REPEATERS REPORTED AN EXPERIENCE OF FAILURE

59%
OF THOSE WITH FAILURES WERE SERIAL ENTREPRENEURS

Paradoxically, serial entrepreneurs' greater propensity to remain overoptimistic may be due in part to the deep pain, even trauma, they feel when their projects fail—pain that is especially acute precisely because they involve themselves in only one business at a time. Psychological research suggests that strong emotions often prompt people to blame others or external events rather than themselves so that they can maintain some semblance of self-esteem and a sense of control. This "attributional bias" appears to make serial entrepreneurs less capable of learning from failure than portfolio entrepreneurs, whose attachment is spread among multiple initiatives.

Some venture capitalists are aware of serial entrepreneurs' aversion to reflecting on failure and make a point of interviewing candidates for investment about the causes of their past successes and mistakes. A 1999 academic study by the consultant Geoffrey H. Smart suggests that a VC firm's ability to assess entrepreneurs is strongly related to its reliance on such interviews. But the practice is far from universal. The study found that the time devoted to this type of screening ranged from zero to 100 hours per investment opportunity. If more potential investors did this due diligence, they might face less exposure to the overconfidence of serial entrepreneurs.

HBR Reprint F1104C

Deniz Ucbasaran is a professor at Warwick Business School, **Paul Westhead** is a professor at Durham Business School, and **Mike Wright** is a professor at Nottingham University Business School, all in the UK.

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NA-1117

Defend Your Research

HBR puts some surprising findings to the test



C. Nathan DeWall (nathan.dewall@uky.edu) is an assistant professor of social psychology at the University of Kentucky.

Hurt Feelings? You Could Take a Pain Reliever...

The finding: Daily doses of acetaminophen alleviate hurt feelings and reduce neural activity related to the pain of social rejection.

The research: The University of Kentucky's C. Nathan DeWall asked 62 undergraduates to take 1,000 milligrams of acetaminophen or a placebo for three weeks. Each evening they recorded how much social pain they'd felt that day. The hurt feelings of those who took acetaminophen decreased significantly over time; people who took the placebo showed no change. In a related study, functional MRIs showed that people who had taken acetaminophen also had less activity in the brain regions that respond to emotional pain.

The challenge: Aren't mental and physical pain entirely different? Can over-the-counter analgesics improve your emotional state if, say, you get fired? **Professor DeWall, defend your research.**

DeWall: My research is really just a continuation of extensive studies over the past three decades showing a significant overlap between social and physical pain processes in animals. Rat pups that are freaking out during separation from a parent become less upset when they're injected with opiates—and not because of any sedative effect. The analgesic actually reduces their distress. No one had looked at whether the same thing might be true of humans. Our experiments used acetaminophen for the obvious reason that it's safer and simpler for people to take on a daily basis than an opiate.

[redacted]: How can you tell if the pain reliever reduces distress or just masks it?

Our subjects knew they'd been rejected; it simply didn't bother them as much. In another part of our research, we had 25 undergraduates undergo functional magnetic resonance imaging while playing a computer-based game in which they were socially included or excluded. During rejection, people who'd taken acetaminophen for three weeks actually showed less activity in the areas of the brain associated with social pain.

Still, distress from rejection isn't really pain—that's just a metaphor, right?

No. We experience social pain differently from physical pain, but there are many commonalities. Probably what happened over the course of human evolution is that as we came to rely more on social inclusion for survival, the body's physical-pain system became the basis for a social-pain system designed to ensure we weren't fending for ourselves in a hostile world. As a result, the social-pain system functions much like its older cousin, which means it responds similarly to analgesics.

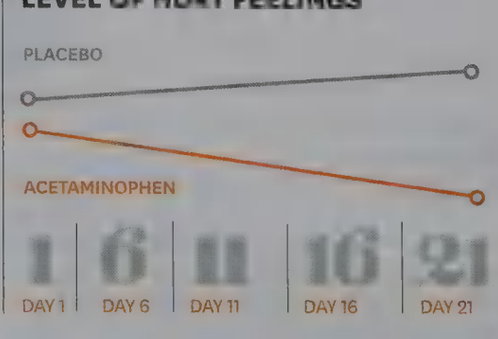
So responses to rejection are hardwired into us, like responses to physical pain?

Exclusion certainly provokes intense reactions. People who've been rejected are more likely to overeat, procrastinate, take financial risks, perform poorly on measures of intelligence, and act aggressively. One thing I want to explore is whether acetaminophen can also help reduce these behavioral consequences. In any case, people will do almost anything to avoid rejection, whether by a friend, a lover, or an employer.

A friend or lover—I can see that. But an employer?

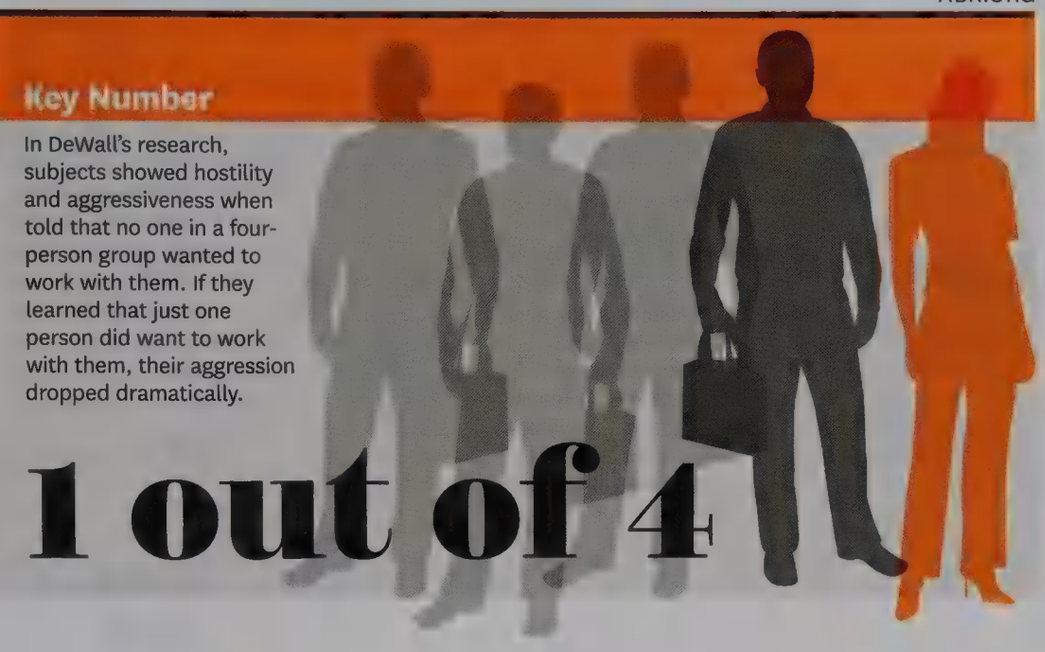
Fear of rejection is probably one reason people make a big effort not to fail at work. Work can be tedious and harmful to

Our social-pain system functions much like our physical-pain system, and responds to analgesics.



Key Number

In DeWall's research, subjects showed hostility and aggressiveness when told that no one in a four-person group wanted to work with them. If they learned that just one person did want to work with them, their aggression dropped dramatically.



1 out of 4

people's health and relationships. Money is thought to be the main compensation for those sacrifices, but don't forget the benefits of social acceptance. The sense of belonging is one of the most important positives of work. In our research, when we ask people to imagine being let go from their jobs, the first thing they tend to say is, "I'm going to lose all my friends." Praise, perks, raises, office parties, outings—employees perceive all those things as evidence of acceptance. They know that to continue to be included, they must avoid failure—they must maintain a certain level of performance. The fear of rejection probably also plays out in another way: It may prevent people from being creative.

That's troubling, because creative thinking is what companies need to grow.

True, but creativity comes with a risk of failure—not all imaginative projects work out. Fear of rejection or even outright termination may sap people's will to be creative. Think of a manager who tells employees to create an iPad app and says that the developer whose app contains the most errors will be fired. On the surface, this may be a rational strategy, but employees' creativity just walked out the door. Google, on the other hand, encourages employees to spend time on activities that are personally meaningful to them, signaling that it doesn't disapprove of initiatives that go nowhere. If your project fizzles, you won't face rejection. A policy like that tends to engender a sense of acceptance, and the research literature suggests this leads to greater innovation.

Should all companies be like Google?

They don't have to go that far. An experiment my colleagues and I did showed that a sense of well-being is boosted by just a little acceptance. When subjects were told that all four people in a group preferred not to work with them, they demonstrated hostility and aggressiveness, but their aggression diminished dramatically if they learned that just one person in the group wanted to work with them. The positive effect of each additional accepting person was much smaller, however. By offering employees frequent tastes of acceptance, firms can harness the full potential of their creativity.

Wouldn't it be easier just to give them acetaminophen?

Definitely not! A lot more research is needed before anyone can say that any analgesic is an effective means of treating social pain. And drugs aren't necessary: It's not hard to create an environment that reduces employees' anxiety about rejection. Rigid rules, for example, send a message that the deviations in thinking that are necessary for creativity won't be tolerated. Greater organizational flexibility can send a message of acceptance, breeding a greater sense of security.

But businesses don't exist to make us feel accepted. Shouldn't employees just suck it up?

Our culture tells us not to make a big deal out of rejection: "Don't be a whiner." But it's just as big a deal as breaking a bone. Even if we try to soldier on, our socially attuned nervous systems are telling us that exclusion is very bad for our survival prospects.

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Vision Statement

When Failure Looks Like Success

The global effort to bring clean water to Bangladesh appeared to be a huge success—twice. But each time, the success contained the seeds of epic failure. The overarching message? Success requires ongoing vigilance. Don't assume the mission is accomplished.

by **Andrew Zolli** and **Ann Marie Healy**; visualization by **Open**.

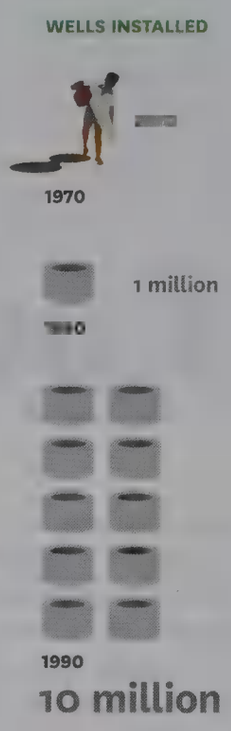


1972

The Fix

MASSIVE SUCCESS

In 1972 UNICEF initiates a project to install tube wells that pull pure underground water to the surface. More and more wells are put in during the next two decades, and three years ahead of the target date most people are getting their water from them. The wells become status symbols, included by many families in their daughters' dowries.



THE PROBLEM

Lack of Potable Water

In the early 1970s most of the rural population uses contaminated groundwater for drinking, bathing, washing clothes and dishes, and irrigation. Waterborne diseases are rampant.

90,000,000
people in a country the size of Iowa

250,000
deaths annually from waterborne diseases



1983

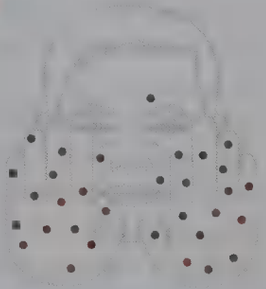
A Disturbing Discovery

EPIC FAILURE

In 1983 a doctor notices "black raindrops" on patients' skin—a sign of arsenic poisoning (lesions are another). Arsenicosis has a latency period as long as 20 years, and over the next decade, even as more wells are installed, more cases are diagnosed. They are linked to well water contaminated with arsenic, which occurs naturally in the country's rocks and soil. In 2000 the World Health Organization cites the crisis as "the largest mass poisoning of a population in history."

EFFECTS OF ARSENICOSIS

Confusion
Numbness
Gangrene
Seizures
Cancer
Organ failure
Coma
Death



Andrew Zolli is the curator of Pop!Tech and the founder of Z+ Partners. He is the author, with **Ann Marie Healy**, of the forthcoming book *Resilience: The Science of Why Things Bounce Back* (Random House). **Open** is a design studio in New York.

Lessons Learned

People say that success has a thousand fathers but failure is an orphan.

Not in this case, however. Many factors caused the Bangladesh well intervention to become a protracted struggle. Here are two of the most important:

Designing "for" instead of "with"
The organizations behind the initial intervention were international bureaucracies with an incomplete understanding of the local population, particularly of rural women. The consequences of their mistakes compounded over time. They should have embraced the community as a codesigner, not merely a recipient, of the solution.

A lack of "whole measurements"
The organizations did not fully assess their projects' impacts. Because they measured success only by the number of wells built and the decline of waterborne illnesses, they missed early signs of the arsenicosis crisis. And they were slow to spot the social problems the painted wells created. They should have developed broader measures of community health and continually monitored them over time, in partnership with the communities.

UNDER-5 MORTALITY RATES
(DEATHS PER 1,000)

1970 — 239

1990 — 149

2000 — 91

97%
of the rural population has [illegible] to well water by 1997.

Fixing the Fix

MASSIVE SUCCESS

In 1999 a multimillion-dollar program of well screening, education, public relations, and social marketing begins. By 2004 it is deemed a success: Wells are painted green (safe) or red (contaminated), and officials report that most residents understand the danger and have stopped using water from the red wells.



1999

2000s

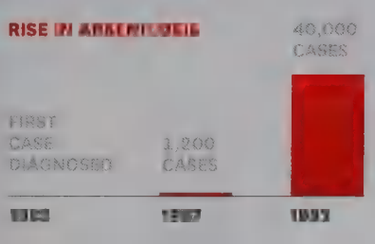
Unforeseen Consequences

NEW FAILURES

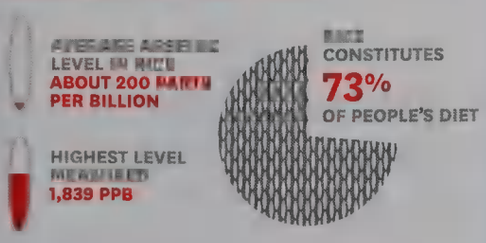
Few follow-up measures are taken after the testing, labeling, and education process. New problems emerge. Villagers who live close to red wells are stigmatized. Those afflicted with arsenic poisoning are discriminated against in employment and social activities and, in the case of young women, face diminished marriage prospects. Some women turn to prostitution to survive.

1 in 5 wells is unsafe.

RISE IN ARSENICOSIS



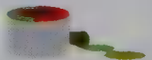
CONTAMINATED WATER LEADS TO TAINTED RICE
(BANGLADESHI CROP, EARLY 2000S)



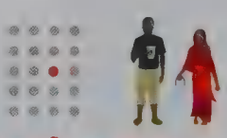
20%



Researchers estimate that diarrheal diseases will increase by 20% among villagers who [illegible] using surface water.



Some owners of contaminated wells repaint them green to avoid the shame associated with red wells.



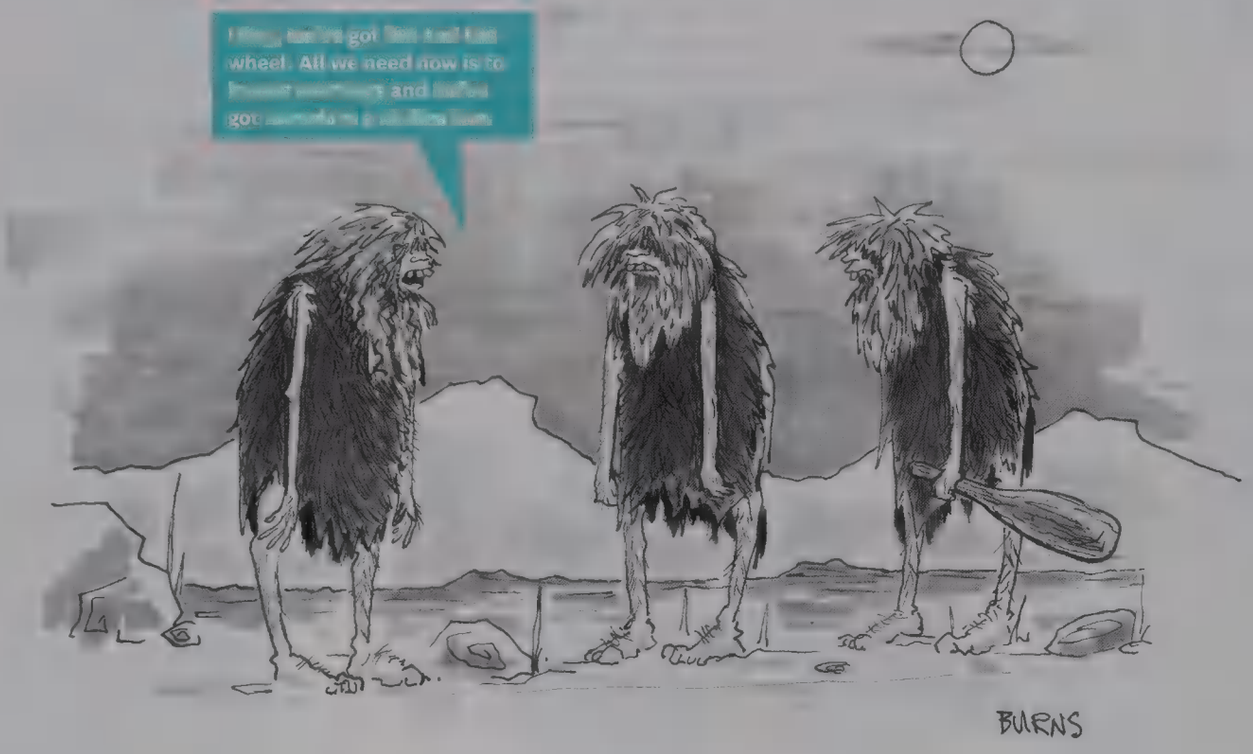
1 in 20

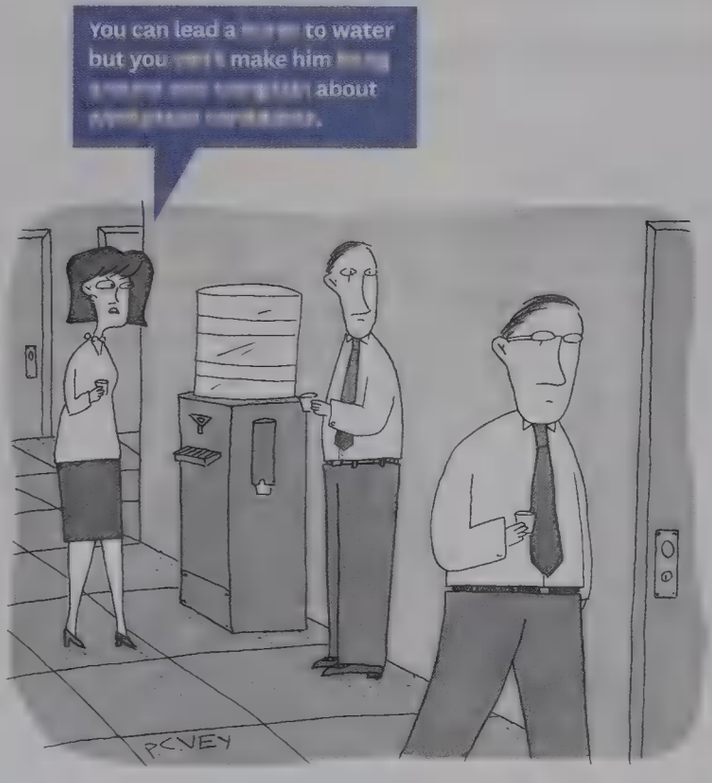
In [illegible] only 5% of parents would allow their children to marry [illegible] with arsenicosis.

SOURCES UNICEF; UN FOUNDATION; WORLD BANK; ANDREW MEHARG, UNIVERSITY OF ABERDEEN

Strategic Humor

To enter this month's contest, go to **hbr.org/magazine** and click "Cartoons from the current issue."





CAPTION CONTEST



"I think the new intern finally figured out how to cash a check."

This month's winning caption was submitted by **Sandra Aaron**, of Toronto, Ontario.

CARTOONS: TERESA BURNS, P.C. VEY, MARK ANDERSON

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Kanter



Rosabeth Moss Kanter holds Harvard Business School's Arbuckle Professorship and specializes in strategy, innovation, and leadership. Her latest book is *SuperCorp* (Crown, 2009).

Cultivate a Culture Of Confidence

One difference between winners and losers is how they handle losing.

Even for the best companies and most-accomplished professionals, long track records of success are punctuated by slips, slides, and mini-turnarounds. Even the team that wins the game might make mistakes, fumble, and lag behind for part of it. That's why the ability to recover quickly and get back on course is so important.

Troubles are ubiquitous. Surprises can fall from the sky like volcanic ash and appear to change everything. New ventures can begin with great promise and still face unexpected obstacles, unanticipated delays, and critics that pop up at the wrong moment. That's why I coined Kanter's Law: "Anything can look like a failure in the middle."

Nothing succeeds for long without considerable effort and constant vigilance. Winning streaks end for predictable reasons: Strategies run their course. New competition emerges to take on the industry leader. Ideas get dusty. Technology marches on. Complacency sets in, making people feel entitled to success rather than motivated to work for it.

Thus, a key factor in high achievement is bouncing back from the low points. Long-term winners often face the same problems as long-term losers, but they respond differently, as I found in the research for my book *Confidence*. I compared companies and sports teams with long winning streaks and long losing streaks, and then looked at how leaders led turnarounds from low to high performance.

Consider first the pathologies of losing. Losing produces temptations to behave in ways that make it hard to recover fast enough—and could even make the situation worse. For example, panicking and throwing out the game plan. Scrambling for self-protection and abandoning the rest of the group. Hiding the facts and hoping that things will get better by themselves before anyone notices. Denying that there is anything to learn or change. Using decline as an excuse to let facilities or investments deteriorate.

The culture and support system that surrounds high performers helps them avoid these temptations. They can put troubles in perspective because they are ready for them. They rehearse through diligent practice and preparation; they remain disciplined and professional. Their leaders put facts on the table and review what went right or wrong in the last round, in order to shore up strengths and pinpoint weaknesses and to encourage personal responsibility for actions. They stress collaboration and teamwork—common goals; commitment to a joint vision; respect and support for team members, so when someone drops the ball, someone else is there to pick it up—and responsibility for mentoring, so the best performers lift everyone's capabilities. They seek creative ideas for improvement and innovation, favoring widespread dialogue and brainstorming.

Troubles are ubiquitous. Surprises can fall from the sky like volcanic ash and appear to change everything.

Resilience is not simply an individual characteristic or a psychological phenomenon. It is helped or hindered by the surrounding system. Teams that are immersed in a culture of accountability, collaboration, and initiative are more likely to believe that they can weather any storm. Self-confidence, combined with confidence in one another and in the organization, motivates winners to make the extra push that can provide the margin of victory.

The lesson for leaders is clear: Build the cornerstones of confidence—accountability, collaboration, and initiative—when times are good and achievement comes easily. Maintain a culture of confidence as insurance against the inevitable downturns. And while no one should deliberately seek failure, remember that performance under pressure—the ability to stay calm, learn, adapt, and keep on going—separates winners from losers.

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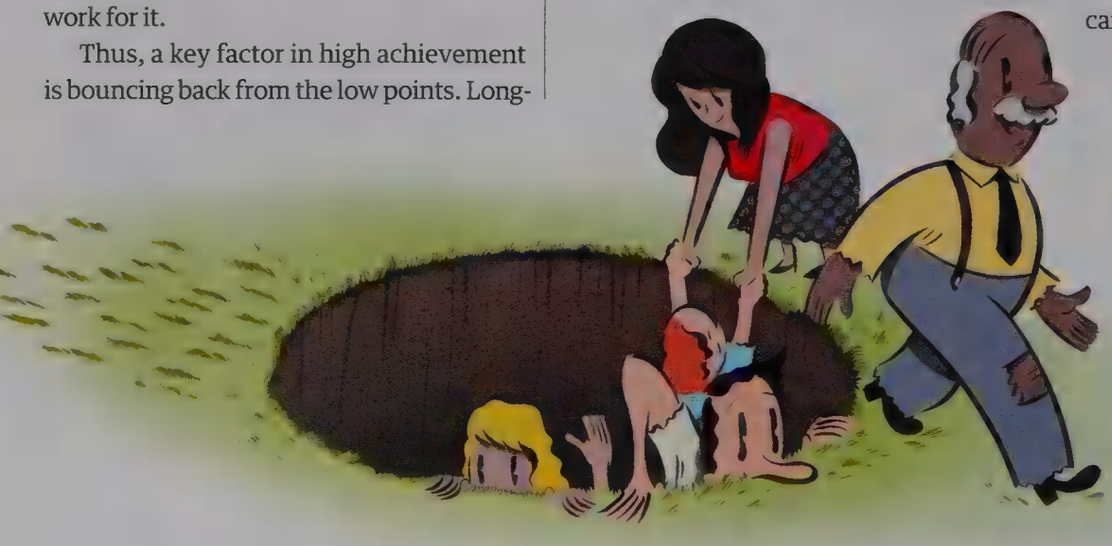


ILLUSTRATION: RYAN SNOOK



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–Josef Berger
Program for Leadership Development 2011

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"AS BUSINESS LEADERS, WE HAVE TO BE GLOBAL. IN THIS NETWORK, WE ARE."

–Priya Durvasula
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Learn More

Isenberg



Daniel Isenberg is a professor of management practice at Babson Global and the executive director of the Babson Entrepreneurship Ecosystem Project.

Entrepreneurs and The Cult of Failure



Policy makers from the government of Singapore to the European Union have advocated "embracing failure" to encourage entrepreneurship. During this year's launch of the White House initiative Startup America, one attendee made an impassioned plea that the United States follow this advice. After all, wasn't it the fearlessness of America's great pioneers—their willingness to stumble during their quest—that led them to succeed against all odds?

Well-intentioned though they may be, these attempts to celebrate failure are misguided. Fear should not be confused with anxiety—and celebrating failure seems aimed at reducing anxiety.

Anxiety, Freud is said to have explained, is when you irrationally react to a simple stick as if it were a dangerous snake. Fear is when you react to a dangerous snake as if it were, well, dangerous. Anxiety is dysfunctional, but fear can be good: It helps protect us from things that are dangerous—such as risk taking. Entrepreneurs, in my experience, develop a healthy fear of what can go wrong. They just don't let it paralyze them.

"Embracing failure" to encourage entrepreneurship is misguided. Failure should not be celebrated.

Here are three ideas to help policy makers calibrate the fear of failure to encourage entrepreneurship without suggesting that failure be vaunted.

Accept that failure is a natural part of doing business. In "hyperentrepreneurial" countries such as Israel, Taiwan, and Iceland, early business failures are common. And the famous J-curve of returns is ideology among venture capitalists everywhere: Failures come early; successes take time. Early failures are important because they generate systemic learning about where opportunities are (and are not) and how to address them, and they quickly free up people, capital, and ideas for more-promising projects. Rapid failure functions like the draft of a chimney: The fast exit of failures sucks in new entrants. Yet many policy makers who encourage entrepreneurship as a strategy for economic development treat low failure rates as a sign that their policies are working. They should be looking for lots successes *and* failures, although the former should, of course, outweigh the latter, in sheer numbers, in impact, or in both.

Remove structural obstacles to reduce the objective risks of a failed venture. Many countries, even those with advanced economies, inadvertently discourage entrepreneurship by punishing bankruptcy: They prevent failed entrepreneurs from conducting future business or even opening bank accounts, and in some cases treat bankruptcy as a crime. Laws that increase the costs of failure stifle engagement from new players, much as a blocked chimney prevents oxygen from feeding the flames. Labor laws are another case in point: Research has shown that eliminating those that make it hard for employers to fire people and instead providing support for laid-off workers makes entrepreneurs much more willing to hire for their start-ups, knowing they can reduce their ranks if necessary.

Turn failure into fodder. Contrary to myth, entrepreneurs are not reckless gamblers. True, risky business is an intrinsic aspect of pushing the innovation envelope. But it's important to train entrepreneurs to fail small, fast, and cheaply. Inexpensive failures don't make headlines—and don't cause embarrassment or shame. Policy makers can support the training of entrepreneurs in risk-mitigation strategies and skills.

If you follow this advice, you won't have to break out the champagne when entrepreneurs fail. Treating failure as a normal aspect of venturing into new business, and developing the right perspective on its value, will help fix the fear of failure without going overboard with festivities in its name.

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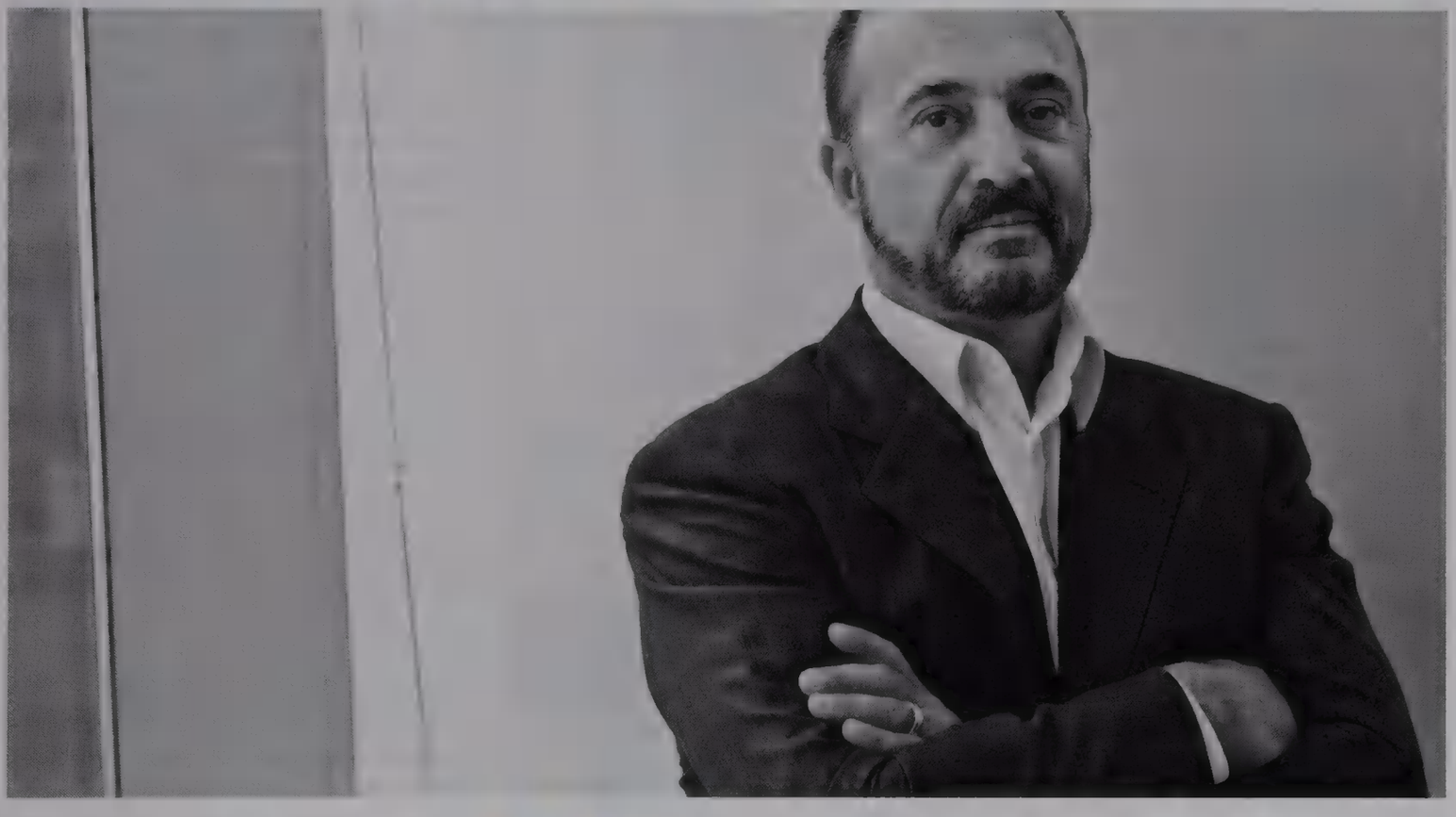
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How I Did It...

Blockbuster's Former CEO On Sparring with an Activist Shareholder



by John Antioco

THE IDEA

After losing a proxy fight to the activist investor Carl Icahn, Blockbuster's then CEO faced a new obstacle: executing strategy in the face of boardroom opposition. He looks back on what he might have done differently.

When my assistant came into my office in early 2005 and told me that Carl Icahn was on the phone, it was a complete surprise. I knew, of course, that Icahn was an "activist shareholder," but I had no idea why he might be calling. Icahn told me he'd bought nearly 10 million shares of Blockbuster, where I'd served as CEO for eight years. I didn't know what kind of play he saw in Blockbuster—and I certainly didn't expect the new challenges his being our biggest shareholder would bring over the next couple of years.

Long before Carl Icahn arrived on the scene, Blockbuster faced its share of challenges. Indeed, expectations of failure were hovering over the company even before I joined in 1997. Most outsiders were convinced that our bricks-and-mortar video retail business would be killed off by market shifts and technological advances. But I firmly believed we could keep the Blockbuster brand relevant, no matter how people decided to watch movies. Even though Blockbuster nearly doubled revenues to more than $6 billion from the time I joined the company, plenty of people were betting against us.

The atmosphere became even more difficult when a group of dissident directors were put into the board mix. CEOs need to

be devising strategy, working with board members, energizing organizations, and dealing with shareholders, but most leaders are ill prepared to handle an activist shareholder who comes at the company with a proxy fight and wins seats on the board. This became readily apparent in 2005. When directors with preconceived notions are determined to serve as obstacles to management's plans, it's hard to find a formula for success. Three years after my departure as CEO, Blockbuster declared bankruptcy.

A Career Built on Turnarounds

In a way, it's ironic that Blockbuster is being featured in a special issue on failure, because I spent most of my career capitalizing on failure by fixing troubled businesses.

After graduating from New York Institute of Technology in 1970, I worked at 7-Eleven. Trainees like me restaffed and restocked failing stores and tried to keep them in business. I was assigned to Long Island—an area where the company had made mistakes in choosing both locations and operators. By the time I was 25, I was a district manager, running 35 stores in Suffolk County. Over time, we transformed the market into one of the company's most profitable. As a result I was promoted—first to northeast division manager, then to national marketing manager, and finally to senior vice president with worldwide responsibilities. In all, I spent 20 years at 7-Eleven. It was a rapidly expanding business with a lot of growing pains, which created many opportunities.

I didn't believe that technology would threaten Blockbuster as fast as critics thought.

After leaving 7-Eleven, I spent a very short time as COO for Pearle Vision; then I became CEO of Circle K, a convenience store chain that was in bankruptcy. We took the company private, improved the business, and three years later sold it to Tosco, an oil company, earning our investors a more than quadrupled return on their money.

Next PepsiCo hired me as CEO of its struggling Taco Bell chain. There I learned an important lesson: Just because you're hired to lead a turnaround doesn't mean you have to throw out the existing strategy. On my fourth day at Taco Bell, its senior managers presented their business plan. Their analysis made sense. I saw no need to change it simply in order to put my fingerprints on it.

We executed the plan and turned three years of negative comparable store sales into positive growth. With that momentum, PepsiCo (which also owned KFC and Pizza Hut) spun off its restaurant group as Tricon. (Today it's Yum! Brands.) Around that time Sumner Redstone, the CEO of Viacom, called. He wanted to talk to me about running Blockbuster.

I met with Redstone for five hours in his bungalow at the Beverly Hills Hotel. It was a very good meeting except for one tense moment, when Sumner called the kitchen and personally reprimanded the chef for boiling his hot dog too long. I ended up working for Sumner for six years, and I never had a bad day with him. I found him to be a big-picture visionary and a very supportive leader.

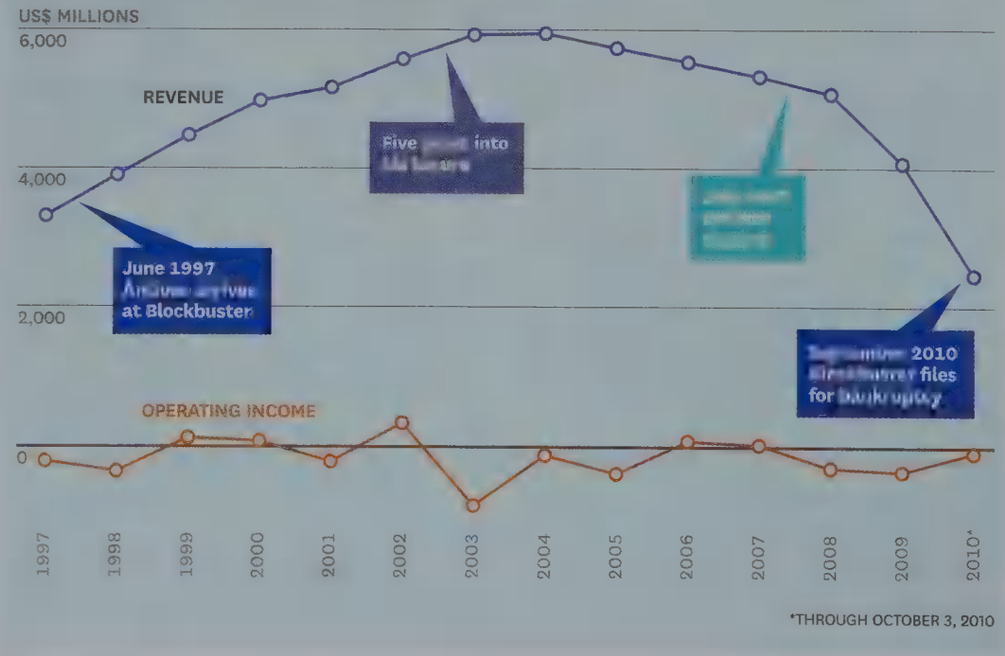
I decided to join Blockbuster for a few reasons: I liked the brand. I saw a lot that could be fixed quickly. And I didn't believe that technology would threaten the company as fast as critics thought. Blockbuster was by far the biggest video rental company, but its market share was only 25%. To me, that was an opportunity.

A Challenging Model

A lot of what I learned about business came from my father, who was an independent milkman in Brooklyn. He believed that you need to focus on always giving customers what they want while still making money

Antioco's Tenure at Blockbuster

...by the numbers.



*THROUGH OCTOBER 3, 2010

for the company. That's what I set out to do at Blockbuster.

Blockbuster's biggest problem stemmed from its business model. Movie studios sold VHS cassettes to rental companies for about $65 apiece, so a store had to rent out each tape about 30 times to make back the money. That's a big up-front investment for a product that most people want just during the few weeks after it first comes out. The whole industry was hurt by stores' never having enough copies of new releases.

We asked the movie studios to shift to a revenue-sharing system. We proposed that instead of buying the cassettes for $65 each, we would pay $1 a copy up front but give the studios 40% of rental revenues on their titles. Eventually they agreed. That allowed us to stock many more copies of hot titles and to advertise their availability. We rolled out an ad campaign about guaranteed availability that featured animated Blockbuster boxes singing the classic tune "I'll Be There." Comp store sales and market share grew strongly.

Even with this success, people continued to worry that video on demand was going to torpedo the rental business. It's ironic that we were hurt by a different technology shift: the advent of the DVD. Whereas VHS cassettes were mostly rented, DVDs were introduced by the studios as a retail product, and mass merchants like Walmart and Best Buy priced them below $20. The adoption rate soared.

DVDs also allowed Netflix to take hold, because they could easily be sent through the mail. Previously the video business had been driven by spontaneity: You didn't have any plans for the evening, so you decided to stay in and rent a movie. We weren't sure whether a model in which you managed your selections by means of a queue and got a movie in the mail a few days later would catch on. But in August 2004 we jumped into the online business in a big way. A few months later we made a dramatic change by eliminating late fees, which had always been a major customer irritant. Those moves put Blockbuster back into growth mode.

How to realize leadership potential



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2. Call for Help



3. Address the Issue



4. Apply Resolution

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The day the company's failure will hit me hardest is probably when my own neighborhood store closes.

When we began these initiatives, Viacom still owned about 80% of us. We were planning to spend $200 million to launch Blockbuster Online and another $200 million to eliminate late fees. Viacom didn't think these investments made sense for its own strategy, so it sold its stake in Blockbuster, which became publicly held. Our stock was depressed by the $400 million planned investment—and that set the stage for the proxy fight.

A Fight We Were Doomed to Lose

Icahn got involved with Blockbuster in late 2004, when the company tried to buy Hollywood Video. Our goal was to orchestrate an orderly downsizing of its store-based business and take on its customers as our own while we also focused on developing alternative movie-delivery methods. Icahn bought positions in both companies as an arbitrage play. Ultimately the FTC declined to approve the deal, and another company—Movie Gallery—bought Hollywood Video. After acquiring his interest in Blockbuster, Icahn began giving interviews to the press and writing letters to shareholders (and to me) claiming that we'd botched the acquisition, that we'd spent too much money on our online business, that we shouldn't have ended late fees, and that the CEO (that would be me) was making too much money. By early 2005 he had decided to launch a proxy fight.

I was about as prepared for such a fight as I could be without ever having gone through one. You hire a bunch of lawyers and bankers, who give you their points of view. You hire a proxy solicitation firm. You write a letter to shareholders, and the opposing shareholder writes a letter. The reality is, we'd just been spun off from Viacom, and most of our stock was held by hedge funds. They were all in for a quick pop, and Icahn is well-known in that community. We were probably doomed from the start. I'm sure the hedge funds figured that having Icahn's guys in the boardroom could lead to a deal that would drive up the stock price. At our 2005 shareholder meeting, in a Dallas auditorium, the votes for Icahn's slate of directors were tallied up. The preliminary results showed that we'd lost. I felt like my guts had been ripped out. It was quite emotional. Most in the audience were Blockbuster employees, and quite a few tears were shed.

I went to the podium and basically said, "The results are the results, but as far as I'm concerned, our strategy is still our strategy. We're disappointed, but we'll work with Icahn and his designees to carry out the mission of the company."

Soon after that I went to New York and met Icahn in person for the first time. We ate at his favorite Italian restaurant, Il Tinello—they even have a dish named after him: Pasta alla "Icahn." In a social setting Carl is quite engaging. Having dinner with him was actually enjoyable. He has a lot of stories, from past deals to poker games. I came away thinking that maybe we could work this out, and that if Carl or any other directors had any good ideas, they should bring them on.

Carl and his two chosen directors were now on our board of eight. Even though he lacked a majority, sheer force of will gave him a lot of power. Since it could be a formidable task, after a while the other directors were disinclined to pick a fight with him. Then one of the sitting board members retired, and Carl and his directors kept vetoing choices for a replacement. The board settled on someone whom Carl would support for whatever reason. So within a few months he effectively controlled the board.

Carl never physically attended a board meeting at Blockbuster's corporate headquarters in Dallas—he called in. It's always hard when someone calls in to a board meeting, and with Carl it's even more difficult. He likes to make himself heard, and he can go on forever. He's not shy about interrupting, and he's not known for boardroom protocol. Frankly, it was a bit of a free-for-all. Eventually, to avoid having to deal with Carl on the phone, I began holding half the board meetings at his New York office. He was winning the power struggle bit by bit.

PHOTOGRAPHY: THE PATRIOT-NEWS

Having contentious directors was a nightmare; as management, we spent much of our time justifying everything we did. One of them had a bunch of ideas, such as putting greeting cards in the stores, carrying adult movies, and making a deal with Barnes & Noble to add a book section. Mostly, though, they questioned our strategy, which focused on growing an online business and finding new ways to satisfy customers, like getting rid of late fees. We presented data demonstrating that franchisees that had dropped late fees were outperforming those that retained them, but they remained unmoved. They wanted us to reinstate late fees, which would have been a disaster—as apparently it was when they were reinstated after my departure.

In December 2006 the situation finally came to a head over executive compensation. Blockbuster had a very good year, and management was due big bonuses. At the board meeting, when it came time to discuss bonuses, the board went into executive session, meaning I had to leave the room. When I came back in, they had decided that my bonus would be greatly reduced, despite my contract. I said I wouldn't take it and that I'd see them in arbitration. A few weeks later they cut me a check. I returned it.

Ditching the Existing Strategy

The compensation issue led to a long Friday-night phone discussion between Carl and me. We finally agreed that I'd leave the company in July 2007 and would be paid a negotiated bonus plus an exit package. I felt good. I felt it was time to leave. The board environment had become very frustrating and stressful, but instead of resigning and walking away with nothing, I had cut a deal giving me a major portion of the pay I was entitled to. After that phone call, I celebrated by having a margarita or two with my wife.

Although I was a lame-duck CEO for the next six months, I remained fully engaged, and the business was doing well. I firmly believe that if our online strategy had not been essentially abandoned, Blockbuster

Why Blockbuster Failed

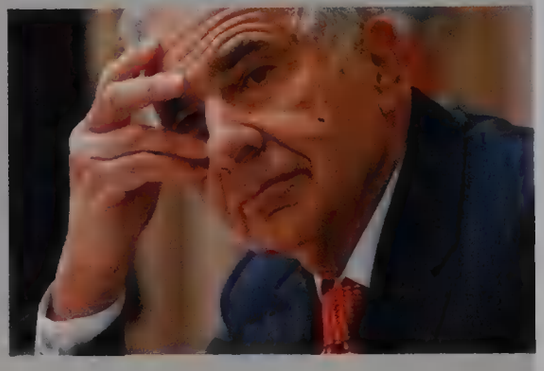
by carl icahn

I liked John Antioco personally. He's not a bad guy. He was a capable executive, but I wasn't impressed with his work ethic—his heart didn't seem in it. When I launched the proxy fight at Blockbuster, the feeling that he'd botched the Hollywood Video deal was widespread. The biggest issue was his excessive compensation package. Investors were outraged that he'd get $50 million if there was a change of control. That was the nail in his coffin. I've been involved in many proxy fights, but Blockbuster was easy. We won the vote by a huge margin. Antioco was really unpopular among shareholders.

I want to clarify a few things here. It's not true that I controlled Blockbuster's board. The two directors I brought in were independent, experts in the media industry, and not "my guys"—they sometimes voted against my position. I'm also not so domineering in the boardroom. During the dispute over Antioco's 2006 bonus, for instance, I was strongly against giving him the money, but even his friends on the board were irate about it. His departure wasn't just my wish—the board was not unhappy when he left.

I have a long track record of stepping in as a director and helping clean up companies like Federal-Mogul, Motorola, XO Communications, Philip Services, National Energy, and Yahoo. As a result, I've done very well. [Editor's note: *Forbes* estimates Icahn's net worth at $11 billion.] The fact that I can make so much money as an activist investor shows that something's wrong with governance in most of corporate America. There's no accountability for CEOs. There are good CEOs and good boards, but too many directors don't care. Activist investors provide some accountability and can be important catalysts for change.

Blockbuster turned out to be the worst investment I ever made. It failed because of too much debt and changes in the industry. It had too many stores, Netflix created a better business model, and then Redbox kiosks and the whole digital phenomenon eliminated the need for consumers to go to a separate DVD store. Maybe the board did make a mistake in picking Jim Keyes as Antioco's successor—Keyes knows retailing and did an excellent job with the stores, but he isn't a digital guy. I also think Antioco did a good job in executing on Blockbuster's Total Access program, which allowed customers to rent unlimited movies online and in stores. Over time it might have helped Blockbuster fend off Netflix. But Keyes felt the company couldn't afford to keep losing so much money, so we pulled the plug. To this day I don't know what would have happened if we'd avoided the big blowup over Antioco's bonus and he'd continued growing Total Access. Things might have turned out differently.



Blockbuster turned out to be the worst investment I ever made.

Carl Icahn is the chairman of Icahn Enterprises.

I sold my Blockbuster stock and bought a bunch of Netflix shares. It wasn't an emotional investment.

Online would have 10 million subscribers today, and we'd be rivaling Netflix for the leadership position in the internet downloading business.

For months the directors searched for a new CEO. After my departure they passed over an inside candidate I favored in order to hire Jim Keyes, with whom I'd worked years before at 7-Eleven. I didn't think he was the best person for the job, but obviously it wasn't my decision. I followed Blockbuster very closely for a few months after my departure, partly because I still held stock and options. Even though Blockbuster Online was growing incredibly fast and we had successfully slowed Netflix's momentum, Keyes made it very public that management planned to drastically change the strategy. The company announced a big price increase for online customers, cut way back on marketing, and decided to intensify the focus on the store-based business. Part of that was an ill-fated attempt to take over Circuit City, which went bankrupt soon afterward. All the members of the senior management team I'd worked with left the company. I sold my stock and bought a bunch of Netflix shares, which were then priced around $20. It wasn't an emotional investment. I could see that Netflix was going to have the whole DVD-by-mail market handed to it, along with a direct path to streaming movies into homes—which is exactly what Netflix has done. I thought I was a genius when I sold my shares at about $35. Today they're over $200.

I believe that Carl lost about $200 million of his original Blockbuster stock investment. I'd have been very happy if he had been able to figure out how to help the company succeed in a difficult environment for many reasons. Carl is very good at what he does—he can make investors rich. But my experiences with him at Blockbuster suggest that his expertise lies in areas other than helping to set a company's strategy while being a busy activist investor.

In hindsight, there are things that could have been done differently. It was probably a mistake to sell Viacom's 80% stake all at once—that's a lot of stock for a market that hasn't really been following the company. I probably should have met with Carl earlier, before the proxy fight, to lay out what we were doing and why. That might or might not have had an impact on his desire to hold on to the stock. And if I could turn back the clock, I might focus on the online business for a few more years and then drop late fees. Both were the right thing to do, but doing them simultaneously increased costs and made a bitter pill for investors.

I was home watching the morning news on September 23, 2010, when I saw that Blockbuster had filed for bankruptcy. I wasn't surprised—there'd been speculation that this day was coming—but I was sad and disappointed. I had spent roughly a quarter of my adult life leading that company, so I felt a sense of loss and some anger at the company's near demise. To be honest, my emotions about Blockbuster are still complicated.

The day the company's failure will hit me hardest is probably when my own neighborhood store closes. I went in there recently with my son, who's now eight. We have a deal where if he behaves well at church, I take him to Blockbuster and let him pick out a movie or a video game. On that visit we rented a couple of Wii games. As I looked around, realizing that this local institution probably wouldn't be there much longer, I felt an almost overwhelming sadness. My team and I had worked hard to create a future for this company. Unfortunately, turnarounds don't always stay turned around forever.

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CARTOON: JOSEPH FARRIS

John Antioco was CEO of Blockbuster from 1997 to 2007. Today he invests in retail franchise concepts.

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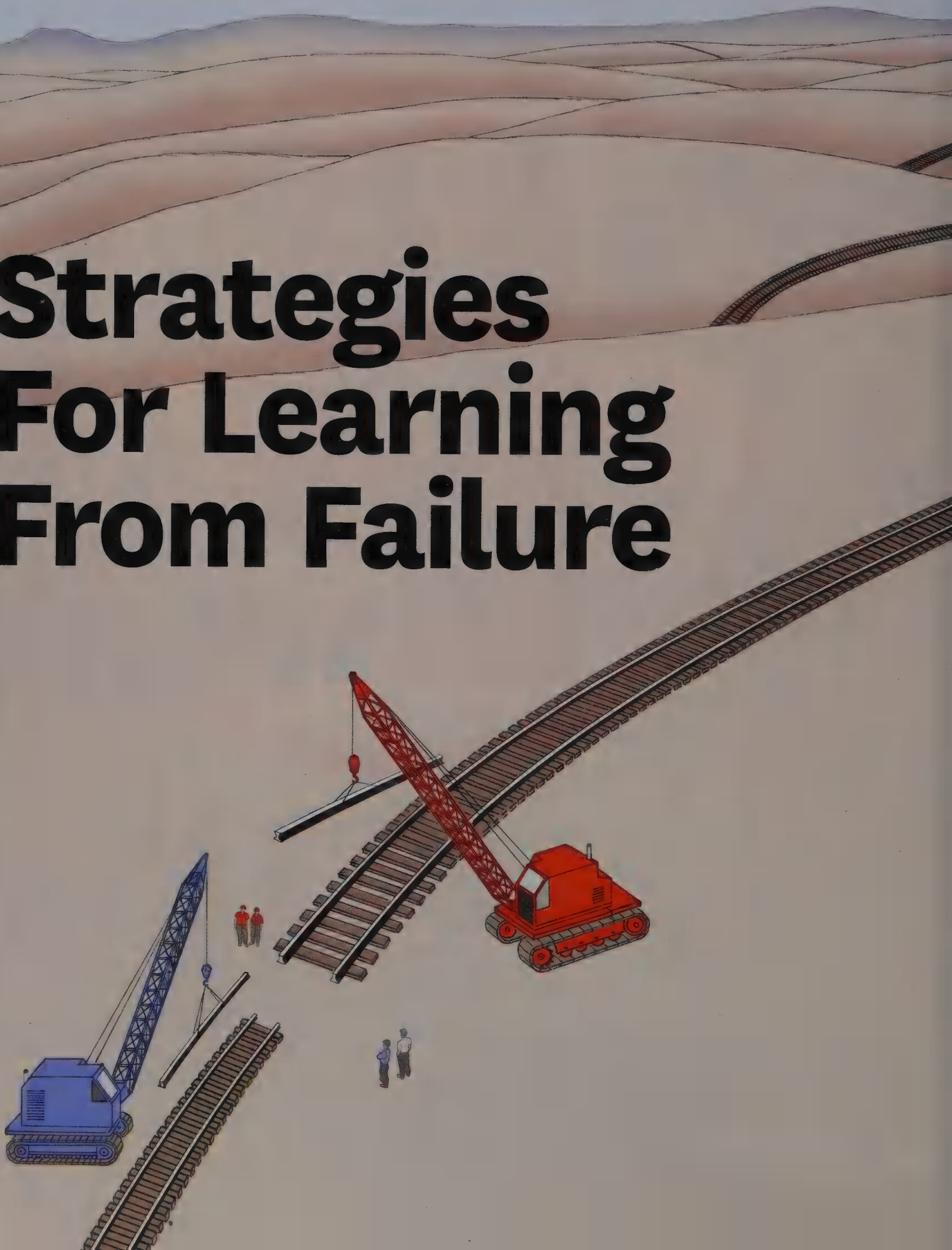
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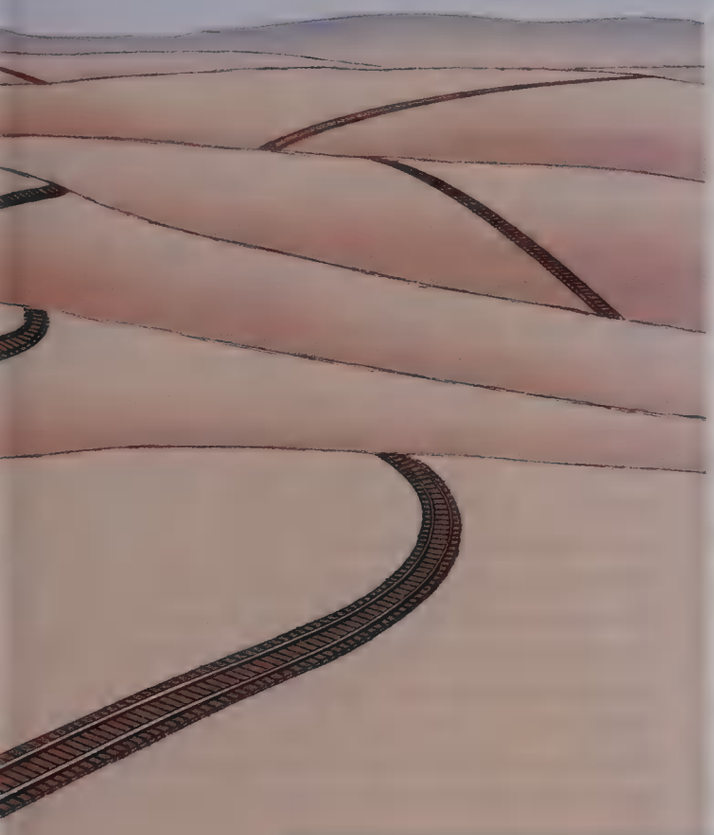
Failure. We're hypocrites about it. Go online, and you'll find scores of pleasant aphorisms celebrating the inevitability of failure and the importance of learning from it. But in real life—and in real companies—failure is anathema. We're afraid of it. We avoid it. We penalize it.

It's time for managers to get past platitudes and confront the F-word taboo. In this special issue every article provides some home truths about good failures (when we expect to fail and learn something), bad failures (when we're sabotaged by errors in judgment), or unavoidable failures (when complex systems break down).

Failure *is* inevitable and often out of our control. But we can choose to understand it, to learn from it, and to recover from it.

Strategies For Learning From Failure





Amy C. Edmondson
is the Novartis Professor of Leadership and Management and co-head of the Technology and Operations Management unit at Harvard Business School.

We are programmed at an early age to think that failure is bad. That belief prevents organizations from effectively learning from their missteps.

by Amy C. Edmondson

THE WISDOM OF LEARNING from failure is incontrovertible. Yet organizations that do it well are extraordinarily rare. This gap is not due to a lack of commitment to learning. Managers in the vast majority of enterprises that I have studied over the past 20 years—pharmaceutical, financial services, product design, telecommunications, and construction companies; hospitals; and NASA's space shuttle program, among others—genuinely wanted to help their organizations learn from failures to improve future performance. In some cases they and their teams had devoted many hours to after-action reviews, postmortems, and the like. But time after time I saw that these painstaking efforts led to no real change. The reason: Those managers were thinking about failure the wrong way.

Most executives I've talked to believe that failure is bad (of course!). They also believe that learning from it is pretty straightforward: Ask people to reflect on what they did wrong and exhort them to avoid similar mistakes in the future—or, better yet, assign a team to review and write a report on what happened and then distribute it throughout the organization.

These widely held beliefs are misguided. First, failure is not always bad. In organizational life it is sometimes bad, sometimes inevitable, and sometimes even good. Second, learning from organizational failures is anything but straightforward. The attitudes and activities required to effectively detect and analyze failures are in short supply in most companies, and the need for context-specific learning strategies is underappreciated. Organizations need new and better ways to go beyond lessons that are superficial ("Procedures weren't followed") or self-serving ("The market just wasn't ready for our great new product"). That means jettisoning old

ILLUSTRATION: GUY BILLOUT

A Spectrum of Reasons for Failure



DEVIANCE
An individual chooses to violate a prescribed process or practice.

INATTENTION
An individual inadvertently deviates from specifications.

LACK OF ABILITY
An individual doesn't have the skills, conditions, or training to execute a job.

PROCESS INADEQUACY
A competent individual adheres to a prescribed but faulty or incomplete process.

TASK CHALLENGE
An individual faces a task too difficult to be executed reliably every time.

PROCESS COMPLEXITY
A process composed of many elements breaks down when it encounters novel interactions.

UNCERTAINTY
A lack of clarity about future events causes people to take seemingly reasonable actions that produce undesired results.

HYPOTHESIS TESTING
An experiment conducted to prove that an idea or a design will succeed fails.

EXPLORATORY TESTING
An experiment conducted to expand knowledge and investigate a possibility leads to an undesired result.

cultural beliefs and stereotypical notions of success and embracing failure's lessons. Leaders can begin by understanding how the blame game gets in the way.

The Blame Game

Failure and fault are virtually inseparable in most households, organizations, and cultures. Every child learns at some point that admitting failure means taking the blame. That is why so few organizations have shifted to a culture of psychological safety in which the rewards of learning from failure can be fully realized.

Executives I've interviewed in organizations as different as hospitals and investment banks admit to being torn: How can they respond constructively to failures without giving rise to an anything-goes attitude? If people aren't blamed for failures, what will ensure that they try as hard as possible to do their best work?

This concern is based on a false dichotomy. In actuality, a culture that makes it safe to admit and report on failure can—and in some organizational contexts *must*—coexist with high standards for performance. To understand why, look at the exhibit "A Spectrum of Reasons for Failure," which lists causes ranging from deliberate deviation to thoughtful experimentation.

Which of these causes involve blameworthy actions? Deliberate deviance, first on the list, obviously warrants blame. But inattention might not. If it results from a lack of effort, perhaps it's blameworthy. But if it results from fatigue near the end of an overly long shift, the manager who assigned the shift is more at fault than the employee. As we go down the list, it gets more and more difficult to find blameworthy acts. In fact, a failure resulting from thoughtful experimentation that generates valuable information may actually be praiseworthy.

When I ask executives to consider this spectrum and then to estimate how many of the failures in their organizations are truly blameworthy, their answers are usually in single digits—perhaps 2% to 5%. But when I ask how many are *treated* as blameworthy, they say (after a pause or a laugh) 70% to 90%. The unfortunate consequence is that many failures go unreported and their lessons are lost.

Not All Failures Are Created Equal

A sophisticated understanding of failure's causes and contexts will help to avoid the blame game and institute an effective strategy for learning from failure. Although an infinite number of things can go wrong in organizations, mistakes fall into three broad categories: preventable, complexity-related, and intelligent.

Preventable failures in predictable operations. Most failures in this category can indeed be considered "bad." They usually involve deviations from spec in the closely defined processes of high-volume or routine operations in manufacturing and services. With proper training and support, employees can follow those processes consistently. When they don't, deviance, inattention, or lack of ability is usually the reason. But in such cases, the causes can be readily identified and solutions developed. Checklists (as in the Harvard surgeon Atul Gawande's recent best seller *The Checklist Manifesto*) are one solution. Another is the vaunted Toyota Production System, which builds continual learning from tiny failures (small process deviations) into its approach to improvement. As most students of operations know well, a team member on a Toyota assembly line who spots a problem or even a potential problem is encouraged to pull a rope called the andon cord, which immediately initiates a diagnostic and problem-solving process. Production continues unimpeded if the problem can be remedied in less than a minute. Otherwise, production is halted—despite the loss of revenue entailed—until the failure is understood and resolved.

Unavoidable failures in complex systems. A large number of organizational failures are due to the inherent uncertainty of work: A particular combination of needs, people, and problems may have never occurred before. Triaging patients in a hospital emergency room, responding to enemy actions on the battlefield, and running a fast-growing start-up all occur in unpredictable situations. And in complex organizations like aircraft carriers and nuclear power plants, system failure is a perpetual risk.

Although serious failures can be averted by following best practices for safety and risk management, including a thorough analysis of any such events that do occur, small process failures are inevitable. To consider them bad is not just a misunderstanding of how complex systems work; it is counterproductive. Avoiding consequential failures means rapidly identifying and correcting small failures. Most accidents in hospitals result from a series of small failures that went unnoticed and unfortunately lined up in just the wrong way.

Intelligent failures at the frontier. Failures in this category can rightly be considered "good," be-

Idea in Brief

The ingrained attitude that all failures are bad means organizations don't learn from them.

Leaders need to recognize that failures occur on a spectrum from blameworthy to praiseworthy, and that they fall into three categories:

- Failures in routine or predictable operations, which can be prevented
- Those in complex operations, which can't be avoided but can be managed so that they don't mushroom into catastrophes
- Unwanted outcomes in, for example, research settings, which are valuable because they generate knowledge

Although learning from failures requires different strategies in different work settings, the goal should be to detect them early, analyze them deeply, and design experiments or pilot projects to produce them. But if the organization is ultimately to succeed, employees must feel safe admitting to and reporting failures. Creating that environment takes strong leadership.

cause they provide valuable new knowledge that can help an organization leap ahead of the competition and ensure its future growth—which is why the Duke University professor of management Sim Sitkin calls them intelligent failures. They occur when experimentation is necessary: when answers are not knowable in advance because this exact situation hasn't been encountered before and perhaps never will be again. Discovering new drugs, creating a radically new business, designing an innovative product, and testing customer reactions in a brand-new market are tasks that require intelligent failures. "Trial and error" is a common term for the kind of experimentation needed in these settings, but it is a misnomer, because "error" implies that there was a "right" outcome in the first place. At the frontier, the right kind of experimentation produces good failures quickly. Managers who practice it can avoid the *unintelligent* failure of conducting experiments at a larger scale than necessary.

Leaders of the product design firm IDEO understood this when they launched a new innovation-strategy service. Rather than help clients design new products within their existing lines—a process IDEO had all but perfected—the service would help them create new lines that would take them in novel strategic directions. Knowing that it hadn't yet figured out how to deliver the service effectively, the company started a small project with a mattress company and didn't publicly announce the launch of a new business.

Although the project failed—the client did not change its product strategy—IDEO learned from it and figured out what had to be done differently. For instance, it hired team members with MBAs who could better help clients create new businesses and made some of the clients' managers part of the team. Today strategic innovation services account for more than a third of IDEO's revenues.

FOCUS ON FAILURE

M&A

Overpayment for acquisitions is a perennial mistake in business.

$850 million

AMOUNT AOL PAID FOR THE SOCIAL NETWORK BEBO IN 2008

$10 million

AMOUNT AOL SOLD BEBO FOR IN 2010

Tolerating unavoidable process failures in complex systems and intelligent failures at the frontiers of knowledge won't promote mediocrity. Indeed, tolerance is essential for any organization that wishes to extract the knowledge such failures provide. But failure is still inherently emotionally charged; getting an organization to accept it takes leadership.

Building a Learning Culture

Only leaders can create and reinforce a culture that counteracts the blame game and makes people feel both comfortable with and responsible for surfacing and learning from failures. (See the sidebar "How Leaders Can Build a Psychologically Safe Environment.") They should insist that their organizations develop a clear understanding of what happened—not of "who did it"—when things go wrong. This requires consistently reporting failures, small and large; systematically analyzing them; and proactively searching for opportunities to experiment.

How Leaders Can Build a Psychologically Safe Environment

If an organization's employees are to help spot existing and pending failures and to learn from them, their leaders must make it safe to speak up. Julie Morath, the chief operating officer of Children's Hospital and Clinics of Minnesota from 1999 to 2009, did just that when she led a highly successful effort to reduce medical errors. Here are five practices I've identified in my research, with examples of how Morath employed them to build a psychologically safe environment.

FRAME THE WORK ACCURATELY

People need a shared understanding of the kinds of failures that can be expected to occur in a given work context (routine production, complex operations, or innovation) and why openness and collaboration are important for surfacing and learning from them. Accurate framing detoxifies failure.

IN A COMPLEX OPERATION LIKE A HOSPITAL, many consequential failures are the result of a series of small events. To heighten awareness of this system complexity, Morath presented data on U.S. medical error rates, organized discussion groups, and built a team of key influencers from throughout the organization to help spread knowledge and understanding of the challenge.

EMBRACE MESSENGERS

Those who come forward with bad news, questions, concerns, or mistakes should be rewarded rather than shot. Celebrate the value of the news first and then figure out how to fix the failure and learn from it.

MORATH IMPLEMENTED "BLAMELESS REPORTING"—an approach that encouraged employees to reveal medical errors and near misses anonymously. Her team created a new patient safety report, which expanded on the previous version by asking employees to describe incidents in their own words and to comment on the possible causes. Soon after the new system was implemented, the rate of reported failures shot up. Morath encouraged her people to view the data as good news, because the hospital could learn from failures—and made sure that teams were assigned to analyze every incident.

Leaders should also send the right message about the nature of the work, such as reminding people in R&D, "We're in the discovery business, and the faster we fail, the faster we'll succeed." I have found that managers often don't understand or appreciate this subtle but crucial point. They also may approach failure in a way that is inappropriate for the context. For example, statistical process control, which uses data analysis to assess unwarranted variances, is not good for catching and correcting random invisible glitches such as software bugs. Nor does it help in the development of creative new products. Conversely, though great scientists intuitively adhere to IDEO's slogan, "Fail often in order to succeed sooner," it would hardly promote success in a manufacturing plant.

Often one context or one kind of work dominates the culture of an enterprise and shapes how it treats failure. For instance, automotive companies, with their predictable, high-volume operations, understandably tend to view failure as something that can and should be prevented. But most organizations engage in all three kinds of work discussed above—routine, complex, and frontier. Leaders must ensure that the right approach to learning from failure is applied in each. All organizations learn from failure through three essential activities: detection, analysis, and experimentation.

Detecting Failure

Spotting big, painful, expensive failures is easy. But in many organizations any failure that can be hidden *is* hidden as long as it's unlikely to cause immediate or obvious harm. The goal should be to surface it early, before it has mushroomed into disaster.

Shortly after arriving from Boeing to take the reins at Ford, in September 2006, Alan Mulally instituted a new system for detecting failures. He asked managers to color code their reports green for good, yellow for caution, or red for problems—a common management technique. According to a 2009 story in *Fortune,* at his first few meetings all the managers coded their operations green, to Mulally's frustration. Reminding them that the company had lost several billion dollars the previous year, he asked straight out, "Isn't anything *not* going well?" After one tentative yellow report was made about a serious product defect that would probably delay a launch, Mulally responded to the deathly silence that ensued with applause. After that, the weekly staff meetings were full of color.

That story illustrates a pervasive and fundamental problem: Although many methods of surfacing current and pending failures exist, they are grossly underutilized. Total Quality Management and soliciting feedback from customers are well-known techniques for bringing to light failures in routine operations. High-reliability-organization (HRO) practices help prevent catastrophic failures in complex systems like nuclear power plants through early detection. Electricité de France, which operates 58 nuclear power plants, has been an exemplar in this area: It goes beyond regulatory requirements and religiously tracks each plant for anything even slightly out of the ordinary, immediately investigates whatever turns up, and informs all its other plants of any anomalies.

Such methods are not more widely employed because all too many messengers—even the most senior executives—remain reluctant to convey bad news to bosses and colleagues. One senior executive I know in a large consumer products company had grave reservations about a takeover that was already

ACKNOWLEDGE LIMITS

Being open about what you don't know, mistakes you've made, and what you can't get done alone will encourage others to do the same.

AS SOON AS SHE JOINED THE HOSPITAL, Morath explained her passion for patient safety and acknowledged that as a newcomer, she had only limited knowledge of how things worked at Children's. In group presentations and one-on-one discussions, she made clear that she would need everyone's help to reduce errors.

INVITE PARTICIPATION

Ask for observations and ideas and create opportunities for people to detect and analyze failures and promote intelligent experiments. Inviting participation helps defuse resistance and defensiveness.

MORATH SET UP CROSS-DISCIPLINARY TEAMS to analyze failures and personally asked thoughtful questions of employees at all levels. Early on, she invited people to reflect on their recent experiences in caring for patients: Was everything as safe as they would have wanted it to be? This helped them recognize that the hospital had room for improvement. Suddenly, people were lining up to help.

SET BOUNDARIES AND HOLD PEOPLE ACCOUNTABLE

Paradoxically, people feel psychologically safer when leaders are clear about what acts are blameworthy. And there must be consequences. But if someone is punished or fired, tell those directly and indirectly affected what happened and why it warranted blame.

WHEN SHE INSTITUTED BLAMELESS REPORTING, Morath explained to employees that although reporting would not be punished, specific behaviors (such as reckless conduct, conscious violation of standards, failing to ask for help when over one's head) would. If someone makes the same mistake three times and is then laid off, coworkers usually express relief, along with sadness and concern—they understand that patients were at risk and that extra vigilance was required from others to counterbalance the person's shortcomings.

in the works when he joined the management team. But, overly conscious of his newcomer status, he was silent during discussions in which all the other executives seemed enthusiastic about the plan. Many months later, when the takeover had clearly failed, the team gathered to review what had happened. Aided by a consultant, each executive considered what he or she might have done to contribute to the failure. The newcomer, openly apologetic about his past silence, explained that others' enthusiasm had made him unwilling to be "the skunk at the picnic."

In researching errors and other failures in hospitals, I discovered substantial differences across patient-care units in nurses' willingness to speak up about them. It turned out that the behavior of midlevel managers—how they responded to failures and whether they encouraged open discussion of them, welcomed questions, and displayed humility and curiosity—was the cause. I have seen the same pattern in a wide range of organizations.

A horrific case in point, which I studied for more than two years, is the 2003 explosion of the *Columbia* space shuttle, which killed seven astronauts (see "Facing Ambiguous Threats," by Michael A. Roberto, Richard M.J. Bohmer, and Amy C. Edmondson, HBR November 2006). NASA managers spent some two weeks downplaying the seriousness of a piece of foam's having broken off the left side of the shuttle at launch. They rejected engineers' requests to resolve the ambiguity (which could have been done by having a satellite photograph the shuttle or asking the astronauts to conduct a space walk to inspect the area in question), and the major failure went largely undetected until its fatal consequences 16 days later. Ironically, a shared but unsubstantiated belief among program managers that there was little

The slogan "Fail often in order to succeed sooner" would hardly promote success in a manufacturing plant.

they could do contributed to their inability to detect the failure. Postevent analyses suggested that they might indeed have taken fruitful action. But clearly leaders hadn't established the necessary culture, systems, and procedures.

One challenge is teaching people in an organization when to declare defeat in an experimental course of action. The human tendency to hope for the best and try to avoid failure at all costs gets in the way, and organizational hierarchies exacerbate it. As a result, failing R&D projects are often kept going much longer than is scientifically rational or economically prudent. We throw good money after bad, praying that we'll pull a rabbit out of a hat. Intuition may tell engineers or scientists that a project has fatal flaws, but the formal decision to call it a failure may be delayed for months.

Again, the remedy—which does not necessarily involve much time and expense—is to reduce the stigma of failure. Eli Lilly has done this since the early 1990s by holding "failure parties" to honor intelligent, high-quality scientific experiments that fail to achieve the desired results. The parties don't cost much, and redeploying valuable resources—particularly scientists—to new projects earlier rather than later can save hundreds of thousands of dollars, not to mention kickstart potential new discoveries.

Designing Successful Failures

Perhaps unsurprisingly, pilot projects are usually designed to succeed rather than to produce intelligent failures—those that generate valuable information. To know if you've designed a genuinely useful pilot, consider whether your managers can answer yes to the following questions:

Is the pilot being tested under typical circumstances (rather than optimal conditions)?

Do the employees, customers, and resources represent the firm's real operating environment?

Is the goal of the pilot to learn as much as possible (rather than to demonstrate the value of the proposed offering)?

Is the goal of learning well understood by all employees and managers?

Is it clear that compensation and performance reviews are not based on a successful outcome for the pilot?

Were explicit changes made as a result of the pilot test?

Analyzing Failure

Once a failure has been detected, it's essential to go beyond the obvious and superficial reasons for it to understand the root causes. This requires the discipline—better yet, the enthusiasm—to use sophisticated analysis to ensure that the right lessons are learned and the right remedies are employed. The job of leaders is to see that their organizations don't just move on after a failure but stop to dig in and discover the wisdom contained in it.

Why is failure analysis often shortchanged? Because examining our failures in depth is emotionally unpleasant and can chip away at our self-esteem. Left to our own devices, most of us will speed through or avoid failure analysis altogether. Another reason is that analyzing organizational failures requires inquiry and openness, patience, and a tolerance for causal ambiguity. Yet managers typically admire and are rewarded for decisiveness, efficiency, and action—not thoughtful reflection. That is why the right culture is so important.

The challenge is more than emotional; it's cognitive, too. Even without meaning to, we all favor evidence that supports our existing beliefs rather than alternative explanations. We also tend to downplay our responsibility and place undue blame on external or situational factors when *we* fail, only to do the reverse when assessing the failures of others—a psychological trap known as *fundamental attribution error.*

My research has shown that failure analysis is often limited and ineffective—even in complex organizations like hospitals, where human lives are at stake. Few hospitals systematically analyze medical errors or process flaws in order to capture failure's lessons. Recent research in North Carolina hospitals, published in November 2010 in the *New England Journal of Medicine,* found that despite a dozen years of heightened awareness that medical errors result in thousands of deaths each year, hospitals have not become safer.

Fortunately, there are shining exceptions to this pattern, which continue to provide hope that organizational learning is possible. At Intermountain Healthcare, a system of 23 hospitals that serves Utah and southeastern Idaho, physicians' deviations from medical protocols are routinely analyzed for opportunities to improve the protocols. Allowing deviations and sharing the data on whether they actually produce a better outcome encourages physicians to buy into this program. (See "Fixing Health Care on the Front Lines," by Richard M.J. Bohmer, HBR April 2010.)

Motivating people to go beyond first-order reasons (procedures weren't followed) to understanding the second- and third-order reasons can be a major challenge. One way to do this is to use interdisciplinary teams with diverse skills and perspectives. Complex failures in particular are the result of multiple events that occurred in different departments or disciplines or at different levels of the organization. Understanding what happened and how to prevent it from happening again requires detailed, team-based discussion and analysis.

A team of leading physicists, engineers, aviation experts, naval leaders, and even astronauts devoted months to an analysis of the *Columbia* disaster. They conclusively established not only the first-order cause—a piece of foam had hit the shuttle's leading edge during launch—but also second-order causes: A rigid hierarchy and schedule-obsessed culture at NASA made it especially difficult for engineers to speak up about anything but the most rock-solid concerns.

Promoting Experimentation

The third critical activity for effective learning is strategically producing failures—in the right places, at the right times—through systematic experimentation. Researchers in basic science know that although the experiments they conduct will occasionally result in a spectacular success, a large percentage of them (70% or higher in some fields) will fail. How do these people get out of bed in the morning? First, they know that failure is not optional in their work; it's part of being at the leading edge of scientific discovery. Second, far more than most of us, they understand that every failure conveys valu-

Too often, pilots are conducted under optimal conditions rather than representative ones. Thus they can't show what *won't* work.

FOCUS ON FAILURE



ALL THINGS MUST END

In 2006 the world's oldest company—Kongō Gumi, a family-owned Japanese temple builder—closed down. It had been in business for 1,400 years.

able information, and they're eager to get it before the competition does.

In contrast, managers in charge of piloting a new product or service—a classic example of experimentation in business—typically do whatever they can to make sure that the pilot is perfect right out of the starting gate. Ironically, this hunger to succeed can later inhibit the success of the official launch. Too often, managers in charge of pilots design optimal conditions rather than representative ones. Thus the pilot doesn't produce knowledge about what *won't* work.

In the very early days of DSL, a major telecommunications company I'll call Telco did a full-scale launch of that high-speed technology to consumer households in a major urban market. It was an unmitigated customer-service disaster. The company missed 75% of its commitments and found itself confronted with a staggering 12,000 late orders. Customers were frustrated and upset, and service reps couldn't even begin to answer all their calls. Employee morale suffered. How could this happen to a leading company with high satisfaction ratings and a brand that had long stood for excellence?

A small and extremely successful suburban pilot had lulled Telco executives into a misguided confidence. The problem was that the pilot did not resemble real service conditions: It was staffed with unusually personable, expert service reps and took place in a community of educated, tech-savvy customers. But DSL was a brand-new technology and, unlike traditional telephony, had to interface with customers' highly variable home computers and technical skills. This added complexity and unpredictability to the service-delivery challenge in ways that Telco had not fully appreciated before the launch.

A more useful pilot at Telco would have tested the technology with limited support, unsophisticated customers, and old computers. It would have been designed to discover everything that could go wrong—instead of proving that under the best of conditions everything would go right. (See the sidebar "Designing Successful Failures.") Of course, the managers in charge would have to have understood that they were going to be rewarded not for success but, rather, for producing intelligent failures as quickly as possible.

In short, exceptional organizations are those that go beyond detecting and analyzing failures and try to generate intelligent ones for the express purpose of learning and innovating. It's not that managers in these organizations enjoy failure. But they recognize it as a necessary by-product of experimentation. They also realize that they don't have to do dramatic experiments with large budgets. Often a small pilot, a dry run of a new technique, or a simulation will suffice.

THE COURAGE to confront our own and others' imperfections is crucial to solving the apparent contradiction of wanting neither to discourage the reporting of problems nor to create an environment in which anything goes. This means that managers must ask employees to be brave and speak up—and must not respond by expressing anger or strong disapproval of what may at first appear to be incompetence. More often than we realize, complex systems are at work behind organizational failures, and their lessons and improvement opportunities are lost when conversation is stifled.

Savvy managers understand the risks of unbridled toughness. They know that their ability to find out about and help resolve problems depends on their ability to learn about them. But most managers I've encountered in my research, teaching, and consulting work are far more sensitive to a different risk—that an understanding response to failures will simply create a lax work environment in which mistakes multiply.

This common worry should be replaced by a new paradigm—one that recognizes the inevitability of failure in today's complex work organizations. Those that catch, correct, and learn from failure before others do will succeed. Those that wallow in the blame game will not.

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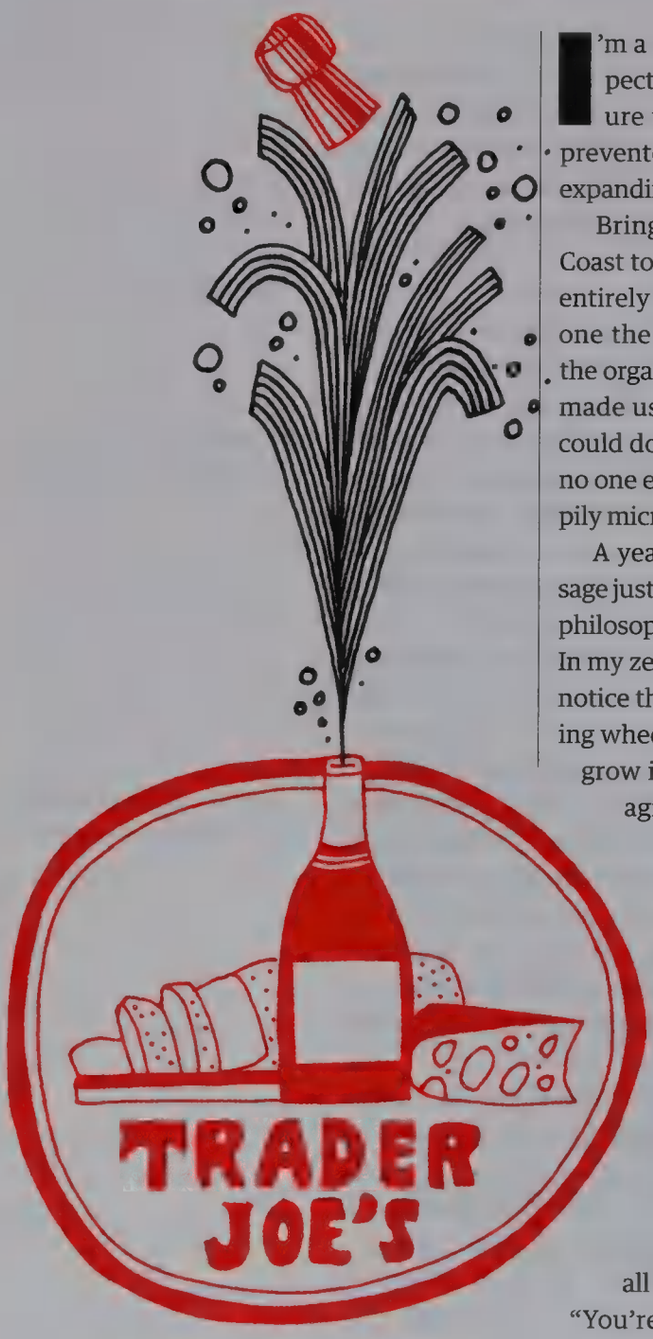
Failure Chronicles



Doug Rauch was president of Trader Joe's grocery stores. He retired in 2008 and is currently a senior fellow at Harvard's Advanced Leadership Institute.

by Doug Rauch, Trader Joe's

"You're driving us crazy. You've got to back off."



I'm a recovering controlaholic, as I suspect a lot of C-suite people are. My failure to recognize this problem nearly prevented Trader Joe's from successfully expanding.

Bringing Trader Joe's from the West Coast to the East meant we had to hire an entirely new staff. We had to teach everyone the Trader Joe's buying philosophy, the organizational culture, the details that made us successful. In my mind, no one could do that better than I could, because no one else had the knowledge I did. I happily micromanaged the expansion.

A year or so in, they'd gotten my message just fine. The culture was instilled, the philosophy bought into. Only I didn't see it. In my zeal to control everything, I failed to notice that it was time to take off the training wheels and let the new staff members grow into their roles. I kept micromanaging. The effect was stifling, especially on our buyers, the heart of our organization. I had always said that a buying team that doesn't make mistakes isn't worth a damn, yet I wasn't letting them make their own mistakes. They started to be afraid to take chances. It was beginning to affect the business.

Luckily for me, one intrepid senior buyer helped put a stop to all this. She approached me and said, "You're driving us crazy. You've got to back off. We'll make mistakes, but you've got to let us go."

In my zeal to control everything, I kept micromanaging. The effect was stifling.

It was a turning point. I went back to the buying team and admitted my problem. I told them I was "on the wagon" and that I needed them to give me regular feedback or I might fall off. We laughed about it—and the company flourished.

As I worked on letting go, I came to see micromanaging as a failure to let others shine or grow. So instead of fixing problems, I focused on nurturing problem solvers. I turned "Try this" into "What do you think we should try?" I replaced the satisfaction of doing something myself, the way I wanted it done, with the joy of watching others do something their way and succeed.

And that turns out to be far more rewarding.

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ILLUSTRATION: CHRISTIAN ROUX

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Good people often let bad things happen. Why? *by Max H. Bazerman and Ann E. Tenbrunsel*

Ethical Breakdowns

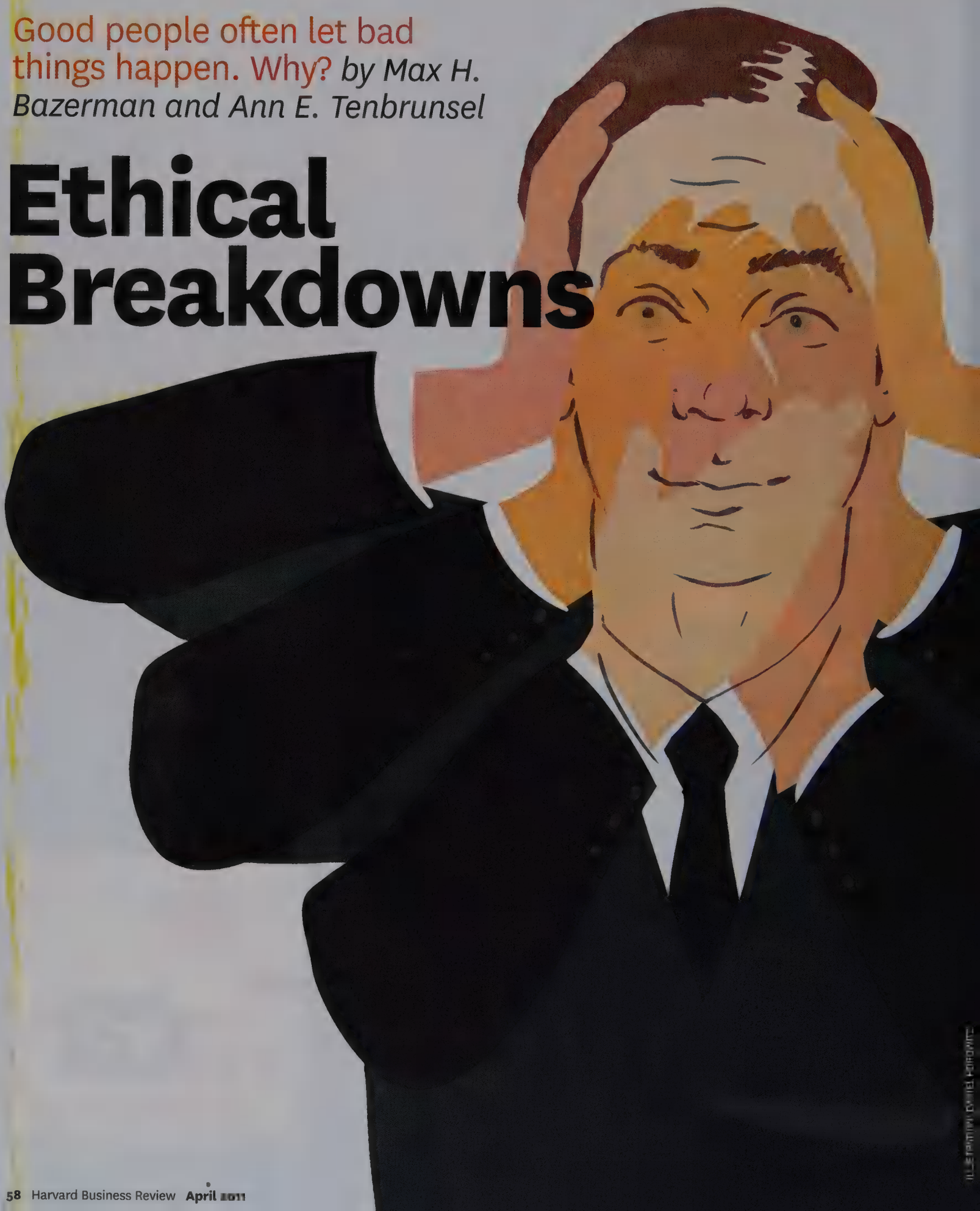


ILLUSTRATION BY DANIEL HERTZBERG



THE VAST MAJORITY of managers mean to run ethical organizations, yet corporate corruption is widespread. Part of the problem, of course, is that some leaders are out-and-out crooks, and they direct the malfeasance from the top. But that is rare. Much more often, we believe, employees bend or break ethics rules because those in charge are blind to unethical behavior and may even unknowingly encourage it.

Consider an infamous case that, when it broke, had all the earmarks of conscious top-down corruption. The Ford Pinto, a compact car produced during the 1970s, became notorious for its tendency in rear-end collisions to leak fuel and explode into flames. More than two dozen people were killed or injured in Pinto fires before the company issued a recall to correct the problem. Scrutiny of the decision process behind the model's launch revealed that under intense competition from Volkswagen and other small-car manufacturers, Ford had rushed the Pinto into production. Engineers had discovered the potential danger of ruptured fuel tanks in preproduction crash tests, but the assembly line was ready to go, and the company's leaders decided to proceed. Many saw the decision as evidence of the callousness, greed, and mendacity of Ford's leaders—in short, their deep unethicality.

But looking at their decision through a modern lens—one that takes into account a growing understanding of how cognitive biases distort ethical decision making—we come to a different conclusion. We suspect that few if any of the executives involved in the Pinto decision believed that they were making an unethical choice. Why? Apparently because they thought of it as purely a business decision rather than an ethical one.

Taking an approach heralded as rational in most business school curricula, they conducted a formal cost-benefit analysis—putting dollar amounts on a redesign, potential lawsuits, and even lives—and determined that it would be cheaper to pay off lawsuits than to make the repair. That methodical process colored how they viewed and made their choice. The moral dimension was not part of the equation. Such "ethical fading," a phenomenon first described by Ann Tenbrunsel and her colleague David Messick, takes ethics out of consideration and even increases unconscious unethical behavior.

What about Lee Iacocca, then a Ford executive VP who was closely involved in the Pinto launch? When the potentially dangerous design flaw was first discovered, did anyone tell him? "Hell no," said one high company official who worked on the Pinto, according to a 1977 article in *Mother Jones*. "That person would have been fired. Safety wasn't a popular subject around Ford in those days. With Lee it was taboo.

FOCUS ON FAILURE



"My life has been nothing but a failure, and all that's left for me to do is to destroy my paintings before I disappear."

CLAUDE MONET
PAINTER

Whenever a problem was raised that meant a delay on the Pinto, Lee would chomp on his cigar, look out the window and say 'Read the product objectives and get back to work.'"

We don't believe that either Iacocca or the executives in charge of the Pinto were consciously unethical or that they intentionally sanctioned unethical behavior by people further down the chain of command. The decades since the Pinto case have allowed us to dissect Ford's decision-making process and apply the latest behavioral ethics theory to it. We believe that the patterns evident there continue to recur in organizations. A host of psychological and organizational factors diverted the Ford executives' attention from the ethical dimensions of the problem, and executives today are swayed by similar forces. However, few grasp how their own cognitive biases and the incentive systems they create can conspire to negatively skew behavior and obscure it from view. Only by understanding these influences can leaders create the ethical organizations they aspire to run.

Ill-Conceived Goals

In our teaching we often deal with sales executives. By far the most common problem they report is that their sales forces maximize sales rather than profits. We ask them what incentives they give their salespeople, and they confess to actually rewarding sales rather than profits. The lesson is clear: When employees behave in undesirable ways, it's a good idea to look at what you're encouraging them to do. Consider what happened at Sears, Roebuck in the 1990s, when management gave automotive mechanics a sales goal of $147 an hour—presumably to increase the speed of repairs. Rather than work faster, however, employees met the goal by overcharging for their services and "repairing" things that weren't broken.

Sears is certainly not unique. The pressure at accounting, consulting, and law firms to maximize billable hours creates similarly perverse incentives. Employees engage in unnecessary and expensive projects and creative bookkeeping to reach their goals. Many law firms, increasingly aware that goals are driving some unethical billing practices, have made billing more transparent to encourage honest reporting. Of course, this requires a detailed allotment of time spent, so some firms have assigned codes to hundreds of specific activities. What is the effect? Deciding where in a multitude of categories an activity falls and assigning a precise number of minutes to it involves some guesswork—which becomes a component of the billable hour. Research shows that as the uncertainty involved in completing a task increases, the guesswork becomes more unconsciously self-serving. Even without an intention to pad hours, overbilling is the outcome. A system designed to promote ethical behavior backfires.

It's a good idea to look at what you're encouraging employees to do. A sales goal of $147 an hour led auto mechanics to "repair" things that weren't broken.

Let's look at another case in which a well-intentioned goal led to unethical behavior, this time helping to drive the recent financial crisis. At the heart of the problem was President Bill Clinton's desire to increase homeownership. In 2008 the *BusinessWeek* editor Peter Coy wrote:

Add President Clinton to the long list of people who deserve a share of the blame for the housing bubble and bust. A recently re-exposed document shows that his administration went to ridiculous lengths to increase the national homeownership rate. It promoted paper-thin down payments and pushed for ways to get lenders to give mortgage

Idea in Brief

Companies have poured time and money into ethics training and compliance programs, but unethical behavior in business is nevertheless widespread. That's because cognitive biases and organizational systems blind managers to unethical behavior, whether their own or that of others.

All these serve to derail even the best-intentioned managers:

- Goals that reward unethical behavior
- Conflicts of interest that motivate people to ignore bad behavior when they have something to lose by recognizing it
- A tendency to overlook dirty work that's been outsourced to others
- An inability to notice when behavior deteriorates gradually
- A tendency to overlook unethical decisions when the outcome is good

Surveillance and sanctioning systems won't work by themselves to improve the ethics of your organization. You must be aware of these biases and incentives and carefully consider the ethical implications of every decision.

loans to first-time buyers with shaky financing and incomes. It's clear now that the erosion of lending standards pushed prices up by increasing demand, and later led to waves of defaults by people who never should have bought a home in the first place.

The Sears executives seeking to boost repair rates, the partners devising billing policies at law firms, and the Clinton administration officials intending to increase homeownership never meant to inspire unethical behavior. But by failing to consider the effects of the goals and reward systems they created, they did.

Part of the managerial challenge is that employees and organizations require goals in order to excel. Indeed, among the best-replicated results in research on managerial behavior is that providing specific, moderately difficult goals is more effective than vague exhortations to "do your best." But research also shows that rewarding employees for achieving narrow goals such as exact production quantities may encourage them to neglect other areas, take undesirable "ends justify the means" risks, or—most important from our perspective—engage in more unethical behavior than they would otherwise.

Leaders setting goals should take the perspective of those whose behavior they are trying to influence and think through their potential responses. This will help head off unintended consequences and prevent employees from overlooking alternative goals, such as honest reporting, that are just as important to reward if not more so. When leaders fail to meet this responsibility, they can be viewed as not only promoting unethical behavior but blindly engaging in it themselves.

Motivated Blindness

It's well documented that people see what they want to see and easily miss contradictory information when it's in their interest to remain ignorant—a psychological phenomenon known as motivated blindness. This bias applies dramatically with respect to unethical behavior. At Ford the senior-most executives involved in the decision to rush the flawed Pinto into production not only seemed unable to clearly see the ethical dimensions of their own decision but failed to recognize the unethical behavior of the subordinates who implemented it.

Let's return to the 2008 financial collapse, in which motivated blindness contributed to some bad decision making. The "independent" credit rating agencies that famously gave AAA ratings to collateralized mortgage securities of demonstrably low quality helped build a house of cards that ultimately came crashing down, driving a wave of foreclosures that pushed thousands of people out of their homes. Why did the agencies vouch for those risky securities?

Part of the answer lies in powerful conflicts of interest that helped blind them to their own unethical behavior and that of the companies they rated. The agencies' purpose is to provide stakeholders with an objective determination of the creditworthiness of financial institutions and the debt instruments they sell. The largest agencies, Standard & Poor's, Moody's, and Fitch, were—and still are—paid by the companies they rate. These agencies made their profits by staying in the good graces of rated companies, not by providing the most accurate assessments of them, and the agency that was perceived to have the laxest rating standards had the best shot at winning new clients. Furthermore, the agencies provide consulting services to the same firms whose securities they rate.

Research reveals that motivated blindness can be just as pernicious in other domains. It suggests, for instance, that a hiring manager is less likely to notice ethical infractions by a new employee than are people who have no need to justify the hire—

particularly when the infractions help the employee's performance. (We've personally heard many executives describe this phenomenon.) The manager may either not see the behavior at all or quickly explain away any hint of a problem.

Consider the world of sports. In 2007 Barry Bonds, an outfielder for the San Francisco Giants, surpassed Hank Aaron to become the all-time leader in career home runs—perhaps the most coveted status in Major League Baseball. (Bonds racked up 762 versus Aaron's 755.) Although it was well known that the use of performance-enhancing drugs was common in baseball, the Giants' management, the players' union, and other interested MLB groups failed to fully investigate the rapid changes in Bonds's physical appearance, enhanced strength, and dramatically increased power at the plate. Today Bonds stands accused of illegally using steroids and lying to a grand jury about it; his perjury trial is set for this spring. If steroid use did help bring the home runs that swelled ballpark attendance and profits, those with a stake in Bonds's performance had a powerful motivation to look the other way: They all stood to benefit financially.

Managers routinely delegate unethical behaviors to others, and not always consciously.

It does little good to simply note that conflicts of interest exist in an organization. A decade of research shows that awareness of them doesn't necessarily reduce their untoward impact on decision making. Nor will integrity alone prevent them from spurring unethical behavior, because honest people can suffer from motivated blindness. Executives should be mindful that conflicts of interest are often not readily visible and should work to remove them from the organization entirely, looking particularly at existing incentive systems.

Indirect Blindness

In August 2005 Merck sold off two cancer drugs, Mustargen and Cosmegen, to Ovation, a smaller pharmaceutical firm. The drugs were used by fewer than 5,000 patients and generated annual sales of only about $1 million, so there appeared to be a clear logic to divesting them. But after selling the rights to manufacture and market the drugs to Ovation, Merck continued to make Mustargen and Cosmegen on a contract basis. If small-market drugs weren't worth the effort, why did Merck keep producing them?

Soon after the deal was completed, Ovation raised Mustargen's wholesale price by about 1,000% and Cosmegen's even more. (In fact, Ovation had a history of buying and raising the prices on small-market drugs from large firms that would have had public-relations problems with conspicuous price increases.) Why didn't Merck retain ownership and raise the prices itself? We don't know for sure, but we assume that the company preferred a headline like "Merck Sells Two Products to Ovation" to one like "Merck Increases Cancer Drug Prices by 1,000%."

We are not concerned here with whether pharmaceutical companies are entitled to gigantic profit margins. Rather, we want to know why managers and consumers tend not to hold people and organizations accountable for unethical behavior carried out through third parties, even when the intent is clear. Assuming that Merck knew a tenfold price increase on a cancer drug would attract negative publicity, we believe most people would agree that using an intermediary to hide the increase was unethical. At the same time, we believe that the strategy worked because people have a cognitive bias that blinds them to the unethicality of outsourcing dirty work.

Consider an experiment devised by Max Bazerman and his colleagues that shows how such indirectness colors our perception of unethical behavior. The study participants read a story, inspired by the Merck case, that began this way: "A major pharmaceutical company, X, had a cancer drug that was minimally profitable. The fixed costs were high and the market was limited. But the patients who used the drug really needed it. The pharmaceutical was making the drug for $2.50/pill (all costs included), and was only selling it for $3/pill."

Then a subgroup of study participants was asked to assess the ethicality of "A: The major pharmaceutical firm raised the price of the drug from $3/pill to $9/pill," and another subgroup was asked to assess the ethicality of "B: The major pharmaceutical X sold the rights to a smaller pharmaceutical. In order to recoup costs, company Y increased the price of the drug to $15/pill."

Participants who read version A, in which company X itself raised the price, judged the company more harshly than did those who read version B, even though the patients in that version ended up paying more. We asked a third subgroup to read both versions and judge which scenario was more

Five Barriers to an Ethical Organization

Even the best-intentioned executives are often unaware of their own or their employees' unethical behavior. Here are some of the reasons—and what to do about them.

	ILL-CONCEIVED GOALS	MOTIVATED BLINDNESS	INDIRECT BLINDNESS	THE SLIPPERY SLOPE	OVERVALUING OUTCOMES
DESCRIPTION	We set goals and incentives to promote a desired behavior, but they encourage a negative one.	We overlook the unethical behavior of others when it's in our interest to remain ignorant.	We hold others less accountable for unethical behavior when it's carried out through third parties.	We are less able to see others' unethical behavior when it develops gradually.	We give a pass to unethical behavior if the outcome is good.
EXAMPLE	The pressure to maximize billable hours in accounting, consulting, and law firms leads to unconscious padding.	Baseball officials failed to notice they'd created conditions that encouraged steroid use.	A drug company deflects attention from a price increase by selling rights to another company, which imposes the increase.	Auditors may be more likely to accept a client firm's questionable financial statements if infractions have accrued over time.	A researcher whose fraudulent clinical trial saves lives is considered more ethical than one whose fraudulent trial leads to deaths.
REMEDIES	Brainstorm unintended consequences when devising goals and incentives. Consider alternative goals that may be more important to reward.	Root out conflicts of interest. Simply being aware of them doesn't necessarily reduce their negative effect on decision making.	When handing off or outsourcing work, ask whether the assignment might invite unethical behavior and take ownership of the implications.	Be alert for even trivial ethical infractions and address them immediately. Investigate whether a change in behavior has occurred.	Examine both "good" and "bad" decisions for their ethical implications. Reward solid decision processes, not just good outcomes.

unethical. Those people saw company X's behavior as less ethical in version B than in version A. Further experiments using different stories from inside and outside business revealed the same general pattern: Participants judging on the basis of just one scenario rated actors more harshly when they carried out an ethically questionable action themselves (directly) than when they used an intermediary (indirectly). But participants who compared a direct and an indirect action based their assessment on the outcome.

These experiments suggest that we are instinctively more lenient in our judgment of a person or an organization when an unethical action has been delegated to a third party—particularly when we have incomplete information about the effects of the outsourcing. But the results also reveal that when we're presented with complete information and reflect on it, we can overcome such "indirect blindness" and see unethical actions—and actors—for what they are.

Managers routinely delegate unethical behaviors to others, and not always consciously. They may tell subordinates, or agents such as lawyers and accountants, to "do whatever it takes" to achieve some goal, all but inviting questionable tactics. For example, many organizations outsource production to countries with lower costs, often by hiring another company to do the manufacturing. But the offshore manufacturer frequently has lower labor, environmental, and safety standards.

When an executive hands off work to anyone else, it is that executive's responsibility to take ownership of the assignment's ethical implications and be alert to the indirect blindness that can obscure unethical behavior. Executives should ask, "When other people or organizations do work for me, am I creating an environment that increases the likelihood of unethical actions?"

The Slippery Slope

You've probably heard that if you place a frog in a pot of boiling water, the frog will jump out. But if you put it in a pot of warm water and raise the temperature gradually, the frog will not react to the slow change and will cook to death. Neither scenario is correct, but they make a fine analogy for our failure to notice the gradual erosion of others' ethical standards. If we find minor infractions acceptable, research suggests, we are likely to accept increasingly major infractions as long as each violation is only incrementally more serious than the preceding one.

Bazerman and the Harvard Business School professor Francesca Gino explored this in an experiment in which the participants—"auditors"—were asked to decide whether to approve guesses provided by "estimators" of the amount of money in jars. The



Rewarding unethical decisions because they have good outcomes is a recipe for disaster over the long term.

auditors could earn a percentage of a jar's contents each time they approved an estimator's guess—and thus had an incentive to approve high estimates—but if they were caught approving an exaggerated estimate, they'd be fined $5. Over the course of 16 rounds, the estimates rose to suspiciously high levels either incrementally or abruptly; all of them finished at the same high level. The researchers found that auditors were twice as likely to approve the high final estimates if they'd been arrived at through small incremental increases. The slippery-slope change blinded them to the estimators' dishonesty.

Now imagine an accountant who is in charge of auditing a large company. For many years the client's financial statements are clean. In the first of two scenarios, the company then commits some clear transgressions in its financial statements, even breaking the law in certain areas. In the second scenario, the auditor notices that the company stretched but did not appear to break the law in a few areas. The next year the company's accounting is worse and includes a minor violation of federal accounting standards. By the third year the violation has become more severe. In the fourth year the client commits the same clear transgressions as in the first scenario.

The auditors-and-estimators experiment, along with numerous similar ones by other researchers, suggest that the accountant above would be more likely to reject the financial statements in the first scenario. Bazerman and colleagues explored this effect in depth in "Why Good Accountants Do Bad Audits" (HBR November 2002).

To avoid the slow emergence of unethical behavior, managers should be on heightened alert for even trivial-seeming infractions and address them immediately. They should investigate whether there has been a change in behavior over time. And if something seems amiss, they should consider inviting a colleague to take a look at all the relevant data and evidence together—in effect creating an "abrupt" experience, and therefore a clearer analysis, of the ethics infraction.

Overvaluing Outcomes

Many managers are guilty of rewarding results rather than high-quality decisions. An employee may make a poor decision that turns out well and be rewarded for it, or a good decision that turns out poorly and be punished. Rewarding unethical decisions because they have good outcomes is a recipe for disaster over the long term.

The Harvard psychologist Fiery Cushman and his colleagues tell the story of two quick-tempered brothers, Jon and Mark, neither of whom has a criminal record. A man insults their family. Jon wants to kill the guy: He pulls out and fires a gun but misses, and the target is unharmed. Matt wants only to scare the man but accidentally shoots and kills him. In the United States and many other countries, Matt can expect a far more serious penalty than Jon. It is clear that laws often punish bad outcomes more aggressively than bad intentions.

Bazerman's research with Francesca Gino and Don Moore, of Carnegie Mellon University, high-

lights people's inclination to judge actions on the basis of whether harm follows rather than on their actual ethicality. We presented the following stories to two groups of participants.

Both stories begin: "A pharmaceutical researcher defines a clear protocol for determining whether or not to include clinical patients as data points in a study. He is running short of time to collect sufficient data points for his study within an important budgetary cycle in his firm."

Story A continues: "As the deadline approaches, he notices that four subjects were withdrawn from the analysis due to technicalities. He believes that the data in fact are appropriate to use, and when he adds those data points, the results move from not quite statistically significant to significant. He adds these data points, and soon the drug goes to market. This drug is later withdrawn from the market after it kills six patients and injures hundreds of others."

Story B continues: "He believes that the product is safe and effective. As the deadline approaches, he notices that if he had four more data points for how subjects are likely to behave, the analysis would be significant. He makes up these data points, and soon the drug goes to market. This drug is a profitable and effective drug, and years later shows no significant side effects."

After participants read one or the other story, we asked them, "How unethical do you view the researcher to be?" Those who read story A were much more critical of the researcher than were those who read story B, and felt that he should be punished more harshly. Yet as we see it, the researcher's behavior was more unethical in story B than in story A. And that is how other study participants saw it when we removed the last sentence—the outcome—from each story.

Managers can make the same kind of judgment mistake, overlooking unethical behaviors when outcomes are good and unconsciously helping to undermine the ethicality of their organizations. They should beware this bias, examine the behaviors that drive good outcomes, and reward quality decisions, not just results.

The Managerial Challenge

Companies are putting a great deal of energy into efforts to improve their ethicality—installing codes of ethics, ethics training, compliance programs, and in-house watchdogs. Initiatives like these don't come cheap. A recent survey of 217 large companies indicated that for every billion dollars of revenue, a company spends, on average, $1 million on compliance initiatives. If these efforts worked, one might argue that the money—a drop in the bucket for many organizations—was well spent. But that's a big if. Despite all the time and money that have gone toward these efforts, and all the laws and regulations that have been enacted, observed unethical behavior is on the rise.

This is disappointing but unsurprising. Even the best-intentioned ethics programs will fail if they don't take into account the biases that can blind us to unethical behavior, whether ours or that of others. What can you do to head off rather than exacerbate unethical behavior in your organization? Avoid "forcing" ethics through surveillance and sanctioning systems. Instead ensure that managers and employees are aware of the biases that can lead to unethical behavior. (This simple step might have headed off the disastrous decisions Ford managers made—and employees obeyed—in the Pinto case.) And encourage your staff to ask this important question when considering various options: "What ethical implications might arise from this decision?"

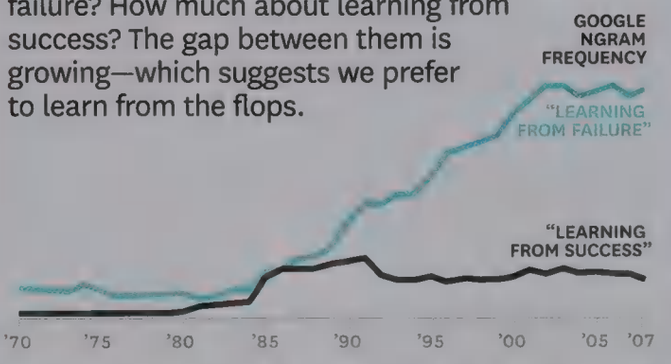
Above all, be aware as a leader of your own blind spots, which may permit, or even encourage, the unethical behaviors you are trying to extinguish.

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FOCUS ON FAILURE

SCHOOL OF HARD KNOCKS

How much do we talk about learning from failure? How much about learning from success? The gap between them is growing—which suggests we prefer to learn from the flops.



GOOGLE BOOKS' NGRAM VIEWER SEARCHES THE TEXT OF MILLIONS OF DIGITIZED BOOKS FOR PHRASES AND COMPARES THEIR FREQUENCY OF USE.

Max H. Bazerman is the Jesse Isidor Straus Professor of Business Administration at Harvard Business School. **Ann E. Tenbrunsel** is the Rex and Alice A. Martin Professor of Business Ethics and the Research Director of the Institute for Ethical Business Worldwide at the University of Notre Dame. They are the authors of *Blind Spots: Why We Fail to Do What's Right and What to Do about It* (Princeton University Press, 2011), from which this article was developed.

Failure Chronicles

Linda Rottenberg is a cofounder and the CEO of Endeavor, a global organization that supports high-impact entrepreneurs in emerging markets.

by Linda Rottenberg, Endeavor

Endeavor India had arrived—but so had everyone else.



As the plane took off for New Delhi, my mind was still grounded in the intense board meeting I had just held in New York. It was 2007, and Endeavor, the organization I had cofounded a decade earlier to support high-impact entrepreneurs around the world, was expanding rapidly. We had offices in nearly a dozen developing countries, from Brazil to Turkey. But our board was agitating.

"Linda," the directors said to me firmly, "we've been operating in emerging markets for 10 years. Why are we not in India?"

We were not in one of the world's fastest-growing economies because I felt that India, with its thriving culture of entrepreneurship, was not the right market for us. Endeavor's mission—to mentor young business leaders, to get them access to capital, to turn them into rock stars—had already landed in India. But the board made a compelling case, arguing that if Endeavor was serious about growth markets, we couldn't ignore one of the biggest in the world—not to mention one in which many of our own entrepreneurs wished to expand.

Once I was on the ground, my resistance softened further. I had encouraging meetings with top business leaders in Delhi, Mumbai, and Bangalore. Sure, India had a vibrant community of entrepreneurs, they told me, but more local innovators were needed. Within months, Endeavor had secured $1.5 million in committed funds—half the capital required to launch local operations—and three (out of the needed six) local business leaders were ready to join the board. At our annual gala, I announced the news: Endeavor India had arrived!

But so had everyone else, I soon realized. Silicon Valley's premier VC firms were already active in India. The media were full of homegrown entrepreneurial success stories like Wipro and Infosys. Although we were off to a successful start, I feared the seeds of failure were already planted.

Still, I was reluctant to give up. I had faced this situation before. A decade earlier, Endeavor's inaugural office, in Chile, had been struggling because of lackluster buy-in from the local business community. I decided to shut down the office. Six months later we reopened, having received calls from many business leaders there expressing their desire to work with us. Endeavor Chile swiftly became one of our top offices, led by an all-star board.

Was India another Chile, I wondered, needing only time to flourish? The answer was no. We had trouble recruiting additional local board members. Also, people were asking Endeavor to relax its "high impact" standards by focusing outside the capital cities, on the base of the pyramid. I feared mission drift. I needed to face reality: Failure was an option.

I soon announced that we would close Endeavor India.

As the leader of a fast-growing organization, I know the importance of setting an ambitious course of action—and stubbornly following it. I believe passion is a powerful guide. But the Law of India, to me, is: You can't always will an outcome. You can't always win. You just need to fail smart.

One of my favorite mantras is "Go big, or go home." Embracing failure is as important as toasting success.

I often think of that plane ride to Delhi and of how important that experience has become to my understanding of entrepreneurship. One of my favorite business mantras is "Go big, or go home." We talk a lot in business—and at Endeavor—about the first half of that equation, "Go big."

But we need to spend a lot more time on the second half, "Go home." Sometimes knowing when to shut down a failed initiative is as vital as knowing when to start one. Sometimes embracing failure is as important as toasting success.

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Calty Design Research, Sienna Team
Newport Beach, CA (pictured) & Ann Arbor, MI

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Why Leaders Don't Learn From Success

Failures get a postmortem. Why not triumphs?

by Francesca Gino and Gary P. Pisano



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THE ANNALS of business history are full of tales of companies that once dominated their industries but fell into decline. The usual reasons offered—staying too close to existing customers, a myopic focus on short-term financial performance, and an inability to adapt business models to disruptive innovation—don't fully explain how the leaders who had steered these firms to greatness lost their touch.

In this article we argue that success can breed failure by hindering learning at both the individual and the organizational level. We all know that learning from failure is one of the most important capacities for people and companies to develop. Yet surprisingly, learning from success can present even greater challenges. To illuminate those challenges—and identify approaches for overcoming them—we will draw from our research and from the work of other scholars in the field of behavioral decision making, and focus on three interrelated impediments to learning.

The first is the inclination to make what psychologists call *fundamental attribution errors.* When we succeed, we're likely to conclude that our talents and our current model or strategy are the reasons. We also give short shrift to the part that environmental factors and random events may have played.

The second impediment is *overconfidence bias:* Success increases our self-assurance. Faith in ourselves is a good thing, of course, but too much of it can make us believe we don't need to change anything.

The third impediment is the *failure-to-ask-why syndrome*—the tendency not to investigate the causes of good performance systematically. When executives and their teams suffer from this syndrome, they don't ask the tough questions that would help them expand their knowledge or alter their assumptions about how the world works.



ILLUSTRATION: JACK BLACK

Lessons from Ducati

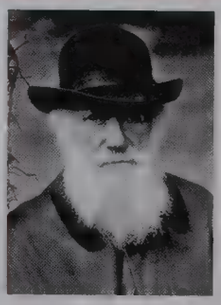
We began to examine the challenges of learning from success in 2004, when we did a case study of an organization with a long history of winning: the Ducati Corse motorcycle racing team. Motorcycle racing may seem a long way from the world of business, but in fact it provides a perfect laboratory for research on learning. Performance is unambiguously measurable by lap times and race results. You know with brutal precision whether you're getting better or worse. Racing is also unforgiving. The race is Sunday, and it won't wait if you're late. Finally, the racing circuit is intensely competitive: During a season a dozen world-class teams battle each week for the top spot. For an organization like Italy's Ducati, wins have a huge impact on brand equity and commercial bike sales.

In 2003, Bologna-based Ducati entered the Grand Prix motorcycle racing circuit (or "MotoGP") for the first time. Being a newcomer, it approached 2003 as "a learning season," its team director told us. The goal was to acquire knowledge that would help it develop a better bike for future seasons. To that end, the team fitted its bikes with sensors that captured data on 28 performance parameters (such as temperature and horsepower). Riders were debriefed after every race to get input on subjective characteristics like handling and responsiveness. The team looked like a model learning organization.

Then something unexpected happened: The rookie team finished among the top three in nine races and was second overall for the season, and its bike was the fastest in the field. But with each success the team focused more on winning and less on learning, and it ended up analyzing little of the data it collected. As one team member commented, "You look at the data when you want to understand what's going wrong. You do not look at the data because you want to understand why you're performing well."

The successful season caused the team members to believe Ducati could win it all in 2004. After all, if they could finish second as rookies, why shouldn't they take first now that they had some experience?

FOCUS ON FAILURE



"I was considered by all my masters and my father a very ordinary boy, rather below the common standard of intellect."

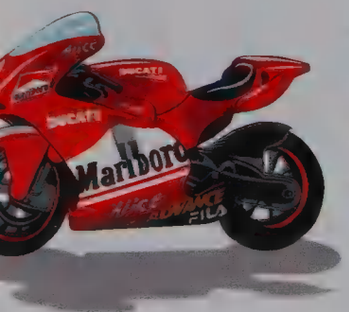
CHARLES DARWIN
SCIENTIST

This confidence manifested itself in the decision to radically redesign the team's bike for the 2004 season rather than incrementally improve the 2003 model.

More than 60% of the 2004 model's 915 components were new. But at the outset of that season, it became apparent that the bike had serious handling problems and that the team had made a big mistake in changing so much at once without giving itself the time to test everything.

Interestingly, the team still finished third overall that year—thanks to extensive experiments it conducted to understand the causes of the bike's problems. Though third place wasn't bad, it was viewed as a failure, given the high expectations. And this disappointment then triggered a comprehensive and ultimately quite effective reexamination of the team's approach to developing bikes. (One big change was to have the engineering group begin developing the bike for the next season much earlier, so it could be thoroughly tested before being raced.) The team turned in solid performances in the 2005 and 2006 seasons and took the world title in 2007. In short, success led the Ducati Corse team to stop learning, and only perceived failure caused it to start again.

After studying Ducati, we went on to conduct research in the entertainment, pharmaceutical, and software industries and performed experiments in the laboratory and in executive education classes. Again and again, we saw the same phenomenon. Ultimately, we recognized that there was a common cause: the three impediments to learning.



Success led the Ducati racing team to stop learning, and only a perceived failure caused it to start again. After its disappointing third-place finish, the team reexamined its approach to developing bikes.

Making Dangerous Attribution Errors

In racing, many interdependent factors affect outcomes. Without a detailed analysis, it was impossible to know whether the Ducati team's performance in 2003 was due to its bike design, its strategy for particular races, its riders' talents and decisions, bad choices by other teams, luck, random events like the weather or crashes, or some complex combination of all those things. And without such knowledge (and given Ducati's long history of winning in other venues), it was too easy to attribute the team's excellent performance to the quality of its decisions, actions, and capabilities.

In business, likewise, any number of factors may lead to success, independent of the quality of a product or management's decisions. Yet it is all too common for executives to attribute the success of their organizations to their own insights and managerial skills and ignore or downplay random events or external factors outside their control. Imagine, for instance, that you are leading a team whose numbers are great: It's tempting to credit yourself or your team's actions for that achievement, though it may actually just be a stroke of good luck or the result of your competitors' problems.

Research (including a classic study by the psychologists Edward Jones and Victor Harris) has proved that this is normal human behavior. Moreover, when examining the bad performance of others, people tend to do the exact opposite. In exercises that we conducted in executive education classes at Harvard, the University of North Carolina at Chapel Hill, and Carnegie Mellon University, most participants, when evaluating the success of others, minimized the role of leadership skills and strategy and maximized the role of external factors and luck.

Another study found that people also have trouble adjusting for the difficulty of the situation when judging successes. (See the sidebar "The Challenge of Discounting Easy Successes.") In business this bias can affect many critical decisions, including whom to hire or promote, which products to launch, and which practices to spread throughout the organization. Someone who has led a thriving business in a highly profitable industry, for instance, often ap-

PHOTOGRAPHY: GETTY IMAGES

Idea in Brief

Virtually all leaders recognize the need to learn from failures, but amazingly few try to understand the true causes of their firms' successes, which helps explain why great companies fall into decline.

The reality is, success can breed failure by hindering learning at both individual and organizational levels, in three interrelated ways:

1 When we succeed, we tend to give too much credit to our talents and our model or strategy and too little to external factors and luck.

2 Success can make us so overconfident that we believe we don't need to change anything.

3 We have a tendency not to investigate the causes of good performance.

Recognizing that these impediments exist is a big first step in overcoming them. Some basic practices also can help: systematic after-action reviews, tools like Six Sigma, and experiments that test assumptions about what is needed to achieve great performance.

pears more attractive than a similarly skilled or even more qualified candidate who has struggled to lead a firm in an industry in which most companies are failing.

We repeatedly observed pharmaceutical companies making these kinds of attribution errors in choosing which drugs to kill or push forward. They selected drugs whose initial tests were successful as potential winners and allocated more money to them for further testing and development. But often managers assumed a success was due to the unique abilities of their in-house scientists and didn't consider whether it could be due to greater general knowledge in that particular scientific area, which competitors might have, too.

In addition, we found that long lead times can blind executives to problems with their current strategies. Again, consider the pharmaceutical industry. Because it takes 12 years, on average, to get a drug from discovery to market, a company's performance today has relatively little to do with its most recent actions and decisions. Yet both managers and investors often attribute today's high performance to the company's current strategy, management, and scientists.

Falling Prey to the Overconfidence Bias

Without some confidence, we could not make decisions or tackle any kind of risky endeavor; we would be constantly second-guessing ourselves. That said, too much confidence can be a problem, and nothing inflates confidence like success. Take Alan Greenspan, who until the near meltdown of the financial system in 2008 was considered one of the best Federal Reserve chairmen in U.S. history. Afterward, it became apparent that Fed policy makers, led by Greenspan, had placed too much faith in their financial models. In testimony to Congress in October 2008, Greenspan acknowledged his own shock that the models had failed. And, of course, he was not the only one who succumbed to excessive confidence. During the housing boom, many leaders of large and small banks and managers of mortgage lending, investing, and trading operations stopped examining the key assumptions that underpinned the models they were using.

Success can make us believe that we are better decision makers than we actually are. In a simple recent study of managers in various industries, we asked members of one group to recall a time when they experienced a success in their professional lives and members of a second group to recall a time when they experienced a failure. We then asked people in both groups to engage in a series of decision-making tasks and embedded measures in the exercise that allowed us to assess their confidence, optimism, and risk-seeking behavior. Compared with the executives who'd recalled a failure, those who'd recalled a success were much more confident in their abilities, made more-optimistic forecasts of their future success, and were more likely to take bigger bets. These findings are consistent with research examining how success breeds overconfidence in other contexts. (See the sidebar "How Power Causes Us to Ignore Advice.")

Overconfidence inspired by past successes can infect whole organizations, causing them to dismiss new innovations, dips in customer satisfaction, and increases in quality problems, and to make overly risky moves. Consider all the companies that grew rapidly through acquisitions only to stumble badly after biting off one too many; the countless banks that made ever-riskier loans in the past decade, sure of their ability to sort good borrowers from bad; and all the darlings of the business media that had winning formulas but did not try to update or alter their strategies until it was way too late.

THE CHALLENGE OF DISCOUNTING EASY SUCCESSES

The inability of people to adjust for degree of difficulty when assessing accomplishments was clearly demonstrated in a study that one of us, Francesca Gino, conducted with Don Moore of Berkeley and Sam Swift and Zachariah Sharek of Carnegie Mellon. Students at a U.S. university assumed the role of admissions officers for an MBA program and were presented with information about candidates' grade point averages as well as the average GPA at their colleges. In their decisions, the participants overweighted applicants' nominal GPAs and underweighted the effect of the grading norms at different schools. In other words, they didn't take into account the ease with which grades were earned.

How Power Causes Us to Ignore Advice

When we're in positions of authority and influence, we tend to shut out those bearing bad news.

Research that Francesca Gino recently conducted with Leigh Tost of the University of Washington and Rick Larrick of Duke University illustrated this phenomenon. In one study a group of participants (students from U.S. universities) were asked to write about a time they had power over other people, a task that significantly boosted their level of confidence. Another group were asked to write about a time other people had power over them, a task that lowered their level of confidence. Then the participants were asked to make a series of decisions with the advice from an expert. When feeling confident, people placed more weight on their own opinion than on the adviser's, even though following the adviser's recommendations would have improved their decisions.

In another study, similar feelings of confidence experienced by a team leader caused the leader to do most of the talking during the team discussion and, as a result, to fail to discover critical information that other team members had.

Failing to Ask Why

When you're confronted with failure, it's natural to ask why disaster struck. Unfortunately, success does not trigger such soul-searching. Success is commonly interpreted as evidence not only that your existing strategy and practices work but also that you have all the knowledge and information you need. Several studies, as well as our own research, show that most people tend to think this way. (See the sidebar "How Success Makes Us Less Reflective.")

We have seen the same pattern in the real world. The efforts invested in understanding the causes of the recent financial crash dwarf the efforts that were made to understand why things seemed to be going so well before. In hospitals, doctors conduct rigorous "mortality and morbidity reviews" of cases that ended badly, but little systematic effort is made to understand why patients recover. Even Toyota, which built its vaunted production system around vigorous learning, was much better at uncovering the causes of its problems than of its success. This was revealed by its recent recalls, when its leaders admitted that their success in pursuing higher sales and market share had blinded them to the fact that operations had essentially compromised quality to achieve growth.

A Simple Model of Learning

To avoid the success-breeds-failure trap, you need to understand how experience shapes learning. Learning is, of course, a highly complex cognitive and organizational process, and numerous models have been developed about it in the academic literature. Drawing from those, we present a simplified model that highlights the effect that success and failure have on learning.

We start with the premise that individuals and organizations at any point in time hold certain theories, models, principles, and rules of thumb that guide their actions. Your choices about the people you hire, the projects you fund (or terminate), the features you include in new product designs, and the business strategies you pursue are all influenced by them. Sometimes theories are quite sophisticated and rooted in science or decades of practical experience. But in many other cases, they are pretty informal—and we may not even be aware that they are swaying our decisions.

Learning is the process of updating our theories. In some cases personal experience alters them. For example, Steve Jobs recounted in a 2005 graduation speech at Stanford University how the inclusion of multiple typefaces and proportional spacing on the first Macintosh stemmed from the calligraphy course he took after dropping out of college. But members of an organization also learn together. Experience with both winners (the iPod) and losers (the Newton) has caused Apple, as a company, to update its theories of what leads to successful products.

From this perspective, learning is all about understanding why things happen and why some decisions lead to specific outcomes. This understanding does not come automatically. We make a conscious choice to challenge our assumptions and models. And usually, we do so as the result of a failure. This has been true from the time we first tried to walk or ride a bicycle. We fall down, it hurts, and we try another approach. An amazing number of high-ranking executives report that early failures in their careers taught them lessons that ultimately led to their success. Failure provides a motivation for organizations to learn, too.

But what about success? Success does not disprove your theory. And if it isn't broken, why fix it? Consequently, when we succeed, we just focus on applying what we already know to solving problems. We don't revise our theories or expand our knowledge of how our business works.

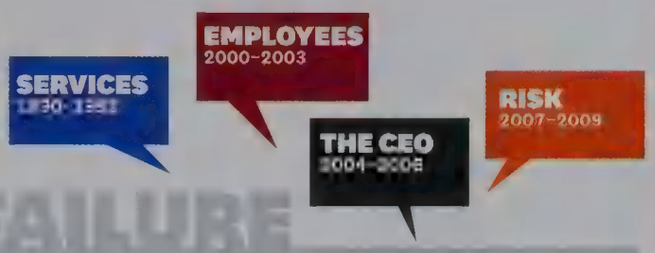
HOW SUCCESS MAKES US LESS REFLECTIVE

In a recent study we conducted in a controlled laboratory setting, students from U.S. universities were asked to work on two decision-making problems. Learning from experience on the first problem could help them perform well on the second. After submitting their solutions to the first problem, the participants were told whether or not they had succeeded. They were then given time to reflect before starting the second problem. Compared with the people who failed at the first problem, those who succeeded spent significantly less time reflecting on the strategies they'd used. This had a cost: Those who succeeded on the first task were more likely to fail on the second. They had neglected to ask why.

FOCUS ON FAILURE

SEMANTICS

The word "failure" appears in HBR with regularity, but the context in which it is used has changed along with the times.



The **TERMS** most frequently used with **FAILURE**, according to semantic clustering analysis

SOURCE HAYDN SHAUGHNESSY, LEXIMANCER

Does success mean "it isn't broken"? Not necessarily. The reality is that while a success (or a string of successes) may mean you're on the right track, you can't assume this to be true without further testing, experimentation, and reflection. You should use success to breed more success by understanding it. Consider Jobs's decision to launch the iPhone, learn from that experience, and apply that knowledge to launch the iPad. Jobs and others at Apple were undoubtedly wary of plunging ahead with the iPad first because of the failure of Apple's Newton tablet in the 1990s. In a brilliant move, they recognized that a touchphone would be easier to launch, given the existing smartphone market, making it the ideal vehicle for Apple to learn about and perfect touch devices.

This example points to a better model for learning, one in which failure and success are on equal footing and both trigger further investigation that helps us revise our assumptions, models, and theories.

Five Ways to Learn

How can you avoid the traps we have discussed? Here are some approaches and strategies that you and your organization can use.

Celebrate success but examine it. There is nothing wrong with toasting your success. But if you stop with the clinking of the champagne glasses, you have missed a huge opportunity. When a win is achieved, the organization needs to investigate what led to it with the same rigor and scrutiny it might apply to understanding the causes of failure.

Recognize that this may be an uncomfortable process. You may learn, for instance, that success was achieved only by happenstance. A biotechnology company we studied, which faced a serious shortage of capacity to produce an important new product, is a case in point. Just when it appeared that the firm would not be able to meet demand, its leaders discovered that a competitor had put a plant up for sale—a stroke of luck that allowed the company to buy all the capacity it needed. The product launched and was extremely successful. Instead of simply rejoicing in their good fortune and moving on, the company's leaders revisited why the introduction had gone so well. That review highlighted the part luck had played. And when they examined why the company had been so vulnerable in the first place, they learned that its demand-forecasting and capacity-planning processes were broken.

The search for causes of success may also identify factors that may be hard or even undesirable to replicate. In one project we studied, a group responsible for developing the software for a complex electronic system was so far behind, it risked delaying a strategic launch. By doubling the size of the team and working 80-hour weeks, the group finished in the nick of time. The product was a major commercial hit. Even so, the company wisely conducted a detailed postproject assessment. While lauding the software development team's dedication, the assessment highlighted critical problems in its process that needed to be fixed.

Institute systematic project reviews. The military holds "after-action reviews" (AARs) of each combat encounter and combat-training exercise, irrespective of the outcome. As in business, the reasons for success or failure in combat often are not clear. AARs are debriefs that, when used properly, generate specific recommendations that can be put to use immediately. Companies can employ the same process, which is relatively straightforward. Like sports coaches and players who convene right after a game to review a team's performance, AAR participants meet after an important event or activity to discuss four key questions: What did we set out to do? What actually happened? Why did it happen? What are we going to do next time?

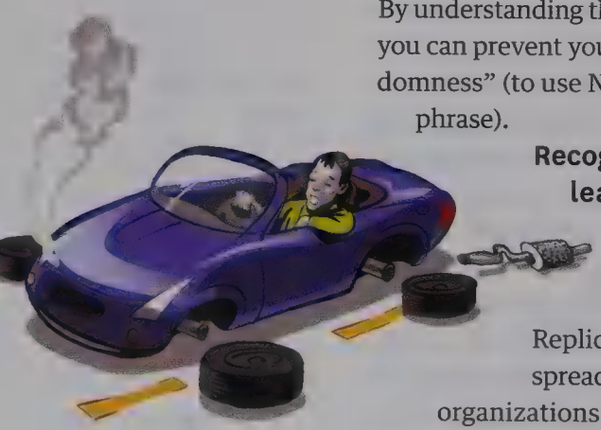
Pixar, which has had 11 hit animated films in a row (and therefore is an organization that would be very vulnerable to the kinds of traps we have discussed), conducts rigorous reviews of the process used to make each of its films. In "How Pixar Fosters Collective Creativity" (HBR September 2008), Ed Catmull, the president of Pixar, confessed that people don't like to do them and would prefer to just celebrate victories and move on. So Pixar employs various methods to ensure that team members don't

If the chief lesson of a successful project is a list of things to do the same way the next time, consider the exercise a failure.

game the system and are engaged in the process. It might ask participants the top five things they would do and the top five things they would not do again. It changes the format of postmortems from time to time. It religiously collects data about all aspects of a production and uses them to "stimulate discussion and challenge assumptions arising from personal impressions" during the postmortems. Finally, it periodically conducts a review across several productions and tries to get someone with an outsider's perspective (a newly hired senior manager, for example) to head it.

The challenge, of course, is to apply the same degree of rigor whether things are going well or badly. Consider performance evaluations. We all tend to spend much more time reviewing the performance of the employee who is struggling than of the one who is cruising along. However, understanding the reasons behind the good performance of successful employees may bring to light important lessons for others.

Use the right time horizons. When the time lag between an action and its consequences is short, it's relatively easy to identify the causes of performance. The problem is that in many cases, the feedback cycle is inherently long. In industries like pharmaceuticals and aerospace, decisions made today about new products or specific technologies to pursue will not bear fruit (or flop) for a decade or more. Unless you have the appropriate time frame for evaluating performance, you are likely to misconstrue the factors that led to success or failure. By understanding the appropriate time dimensions, you can prevent yourself from being "fooled by randomness" (to use Nassim Nicholas Taleb's famous phrase).



Recognize that replication is not learning. When things go well, our biggest concern is how to capture what we did and make sure we can repeat the success. Replication is important; we need to spread good practices throughout our organizations. But if the chief lesson from a successful project is a list of things to do the same way the next time, consider the exercise a failure.

Tools like Six Sigma and total quality management have taught us to dig into root causes of problems. Why not use the same approach to understand the root causes of success? Institute a phase in the process where each factor that contributed to success is classified as "something we can directly control" or "something that is affected by external factors." Factors under your control can remain part of your winning formula. But you need to understand how external factors interact with them.

If it ain't broke, experiment. Experimentation is one way to test assumptions and theories about what is needed to achieve high levels of performance. And it should continue even after a success. This happens all the time in scientific research and in engineering. Engineers routinely subject their designs to ever-more-rigorous tests until the thing they are designing actually breaks. Organizational experiments can also be conducted to push boundaries. Of course, the costs and impact of such experiments need to be managed carefully (to avoid severe financial consequences or harming customers). The right question for leaders of learning organizations to ask is not "What are we doing well?" but rather "What experiments are we running?"

THE PATH to effective learning involves simple but counterintuitive steps: Managers must actively test their theories, even when they seem to be working, and rigorously investigate the causes of both good and bad performance. Ironically, casting a critical eye on your success can better prepare you to avoid failure. Some may consider this to be an art. But in fact it is much more of a science.

Filippo Preziosi, general director for the Ducati Corse team, reflected on this point in the context of racing-bike design: "In racing, when you make a change, you only care whether or not it leads to superior performance. You tend to care less why something works. But over the long term you need to know why. This is the science." ▼

HBR Reprint R1104D

Failure Chronicles

Anthony Tjan is the managing partner and founder of the venture capital firm Cue Ball.

by Anthony Tjan, Cue Ball

On the eve of our IPO, we decided to withdraw the offering.

In the mid-1990s, I, along with a former McKinsey colleague and some Harvard Business School classmates, founded ZEFER. At the time, fewer than 10,000 websites existed in the world. We were one of the first internet strategy and development firms in the United States. Our timing couldn't have been better.

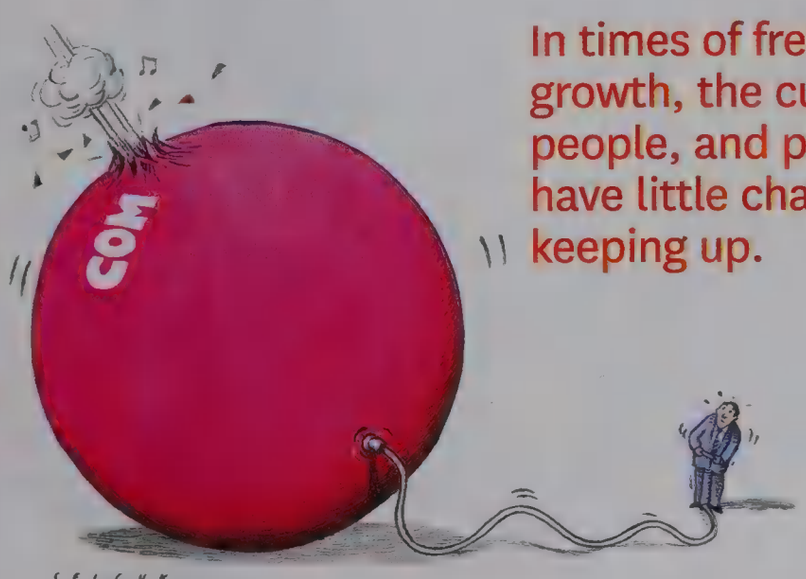
By 2000, ZEFER had grown to 900 people and raised tens of millions of dollars in capital. It boasted an annual revenue pace of more than $100 million. Big global clients like Thomson Reuters, McKinsey, Morgan Stanley, and Siemens had engaged us to develop and implement their internet projects and strategies.

We were an industry darling, and we decided to go public.

That decision precipitated months of legal work and regulatory filings and then an IPO road show, a grueling two weeks of more than 80 meetings across the United States and Europe. The process was a business version of the film *Groundhog Day,* but adrenaline and the interest in our stock kept us going through the 18-hour days.

On April 13, 2000, I was in New York for that ceremonial and celebratory visit to NASDAQ before going public the next day. But uncertainty now hung in the air, and suddenly our timing couldn't have been worse. In the second week of our road show, the NASDAQ had a stunning run of consecutive daily losses. Virtually overnight, the irrationally exuberant dot-com boom turned into a dot-com bust. By the end of the week, the index had lost more than 1,000 cumulative points and was down over one-third from its high point, set only about a month earlier.

On the eve of our planned IPO, we made the decision to withdraw our stock offering.



In times of frenetic growth, the culture, people, and product have little chance of keeping up.

Instead of preparing champagne toasts, I was preparing to inform remarkable colleagues that we had failed to pull it off.

At the time, and from such a height of success, ZEFER's missed IPO felt like a massive failure. But with a decade's perspective, I can better appreciate that disappointing moment for the transformative experience that it was. I'm proud of the business we built—which endures today as part of the Japanese technology conglomerate NEC—and the platform for future success that ZEFER afforded many of us.

And there have been lasting business lessons. Warranted as our meteoric rise seemed at the time, it's clear that a company can digest only a certain pace of growth. In times of frenetic growth, the culture, people, and product have little chance of keeping up. Favorable external factors will always tempt businesses to scale ambitiously. But putting up the biggest sail on a boat when you think you're on a lake but you're actually in the ocean invariably leads to trouble.

I often reflect on how lucky we were to participate in—and influence—a pioneering phase of the internet. It has taught me that extrinsic rewards like salaries and options matter less than the intrinsic ones—namely meaningful experiences. Which isn't to say that there isn't a baseline of economics required and that I wouldn't have liked to hit the jackpot. But the misfortune of our IPO event pales in comparison to the fortune of our experience.

HBR Reprint R1104J

Learn from It

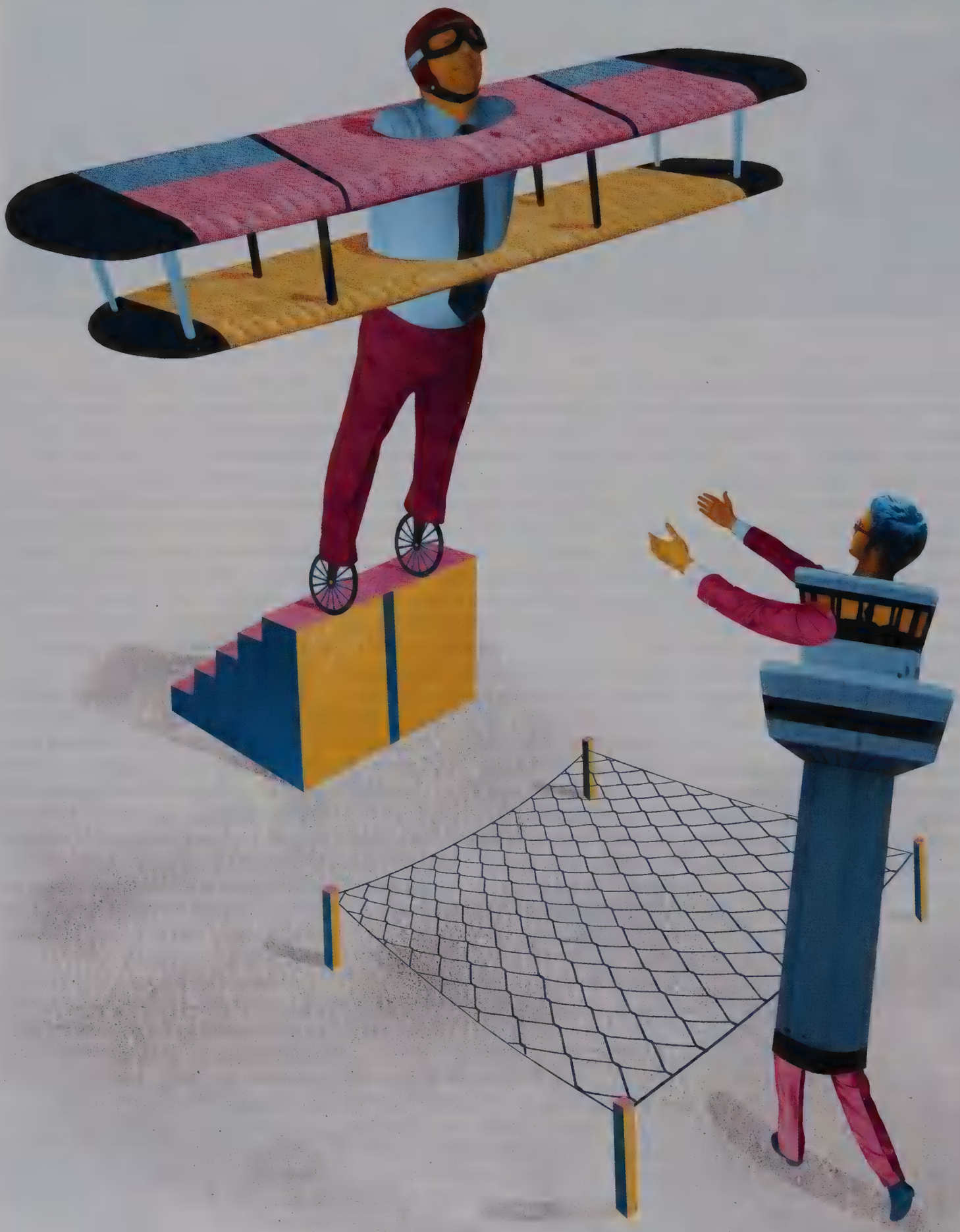


ILLUSTRATION: PHIL WRIGGLESWORTH

Rita Gunther McGrath
(rdm20@columbia.edu),
a professor at Columbia
Business School, researches
strategy and innovation in
volatile environments.



Uncertain environments call for experimentation. Here's how to set up the trials—and learn from the errors. *by Rita Gunther McGrath*

Failing By Design

IT'S HARDLY NEWS that business leaders work in increasingly uncertain environments. Nor will it surprise anyone that under uncertain conditions, failures are more common than successes. And yet, strangely, we don't design organizations to manage, mitigate, and learn from failures. When I ask executives how effective their organizations are at learning from failure, on a scale of one to 10, I often get a sheepish "Two—or maybe three" in response. As this suggests, most organizations are profoundly biased against failure and make no systematic effort to study it. Executives hide mistakes or pretend they were always part of the master plan. Failures become undiscussable, and people grow so afraid of hurting their career prospects that they eventually stop taking risks.

I'm not going to argue that failure per se is a good thing. Far from it: It can waste money, destroy morale, infuriate customers, damage reputations, harm careers, and sometimes lead to tragedy. But failure is inevitable in uncertain environments, and, if managed well, it can be a very *useful* thing. Indeed, organizations can't



WHAT ARE YOUR NO-FAIL ZONES?

Leaders need to be clear about where failure will be tolerated—and where it won't.

Mike Eskew, the former CEO of UPS, put the customer experience out of bounds: "We fail in such a way that it never touches the customer," he said. In practice this meant that UPS didn't experiment with moving, paying for, or otherwise interacting with a package. In all other respects it permitted—even encouraged—entrepreneurial experiments that stretched the century-old company.

possibly undertake the risks necessary for innovation and growth if they're not comfortable with the idea of failing.

An alternative to ignoring failure is to foster "intelligent failure," a phrase coined by Duke University's Sim Sitkin in a terrific 1992 *Research in Organizational Behavior* article titled "Learning Through Failure: The Strategy of Small Losses." If your organization can adopt the concept of intelligent failure, it will become more agile, better at risk taking, and more adept at organizational learning.

How Failure Can Be Useful

Some of the failures I'm about to describe were the results of intentional experiments. Others were completely unplanned and unexpected. But all of them provide valuable takeaways. A certain amount of failure can help you:

Keep your options open. As the range of possible outcomes for a course of action expands, the chances of that action's succeeding diminish. You'll improve your odds if you make more tries. This is the logic driving businesses that operate in highly uncertain environments, such as venture capital firms (whose success rates range from about 10% to about 20%), pharmaceutical companies (which typically create hundreds of new molecular entities before coming up with one marketable drug), and the movie business (where, according to one study, 1.3% of all films earn 80% of the box office).

Learn what doesn't work. Many successful ventures are built on failed projects. Apple's Macintosh computers emerged in part from the ashes of a now-forgotten product called Lisa, which introduced a number of the graphical user interfaces and mouse operations in today's computers.

In truly uncertain situations, conventional market research is of little use. If you had asked people in 1990 what they would be willing to pay for an internet search, no one would have known what you were talking about. A massive amount of experimentation was needed before workable search engines emerged. Early entrants sought to be paid for doing the searches themselves. Later, companies explored business models based on advertising. Later still, Google developed a system to maximize the profitability of the ad-based model. Without all that trial and error, it's highly unlikely that Google could have built the algorithm-based juggernaut so familiar today.

Create the conditions to attract resources and attention. Organizations tend to move on to new projects rather than fix systemic problems with existing ones. Let something big go wrong, though, and it's all hands on deck!

I was personally introduced to how failure can be used strategically years ago, when I worked for the City of New York. I ran an IT group charged with installing an automated procurement system. I was blissfully unaware of how challenging it would be to gain political support and financial resources for the project. Luckily, my boss was a political genius. One afternoon, while I was running some analytics, I learned that the data in the old system had become corrupted. I leaped into action, determined to save the day. But after I ran my plan past my boss, he quietly said, "Don't do any of that. Sometimes things have to fall apart before anybody musters the will to fix them." He was absolutely right. The failure of the old system created a compelling argument for the new one and was a turning point in gaining support.

Make room for new leaders. Sad but true: Even today many leadership positions are held by people very much like those who selected them. Entire industries have suffered the consequences of "lifers" who don't challenge unspoken assumptions and taken-for-granted rules. Only when those assumptions and rules are proven ineffective—often, unfortunately, in the course of great trauma—do boards recruit fresh leaders. The change can be surprisingly beneficial. The U.S. auto industry provides a case in point. Who would have thought that Alan Mulally, a former senior executive at Boeing, would be an inspirational turnaround CEO for Ford?



Idea in Brief

If you're launching a new business, creating a new product, or developing a new technology, the principles of intelligent failure provide both logic and a safety net.

Decide what you're trying to do and what success would look like.

Be explicit about the assumptions you're making and have a plan for testing them throughout the project.

Design the initiative in small chunks so that you learn fast, without spending too much money. Don't try to learn more than one significant thing at a time.

Create a culture that shares, forgives, and sometimes even celebrates failure.

Develop intuition and skill. Researchers say that what people think of as intuition is, at its heart, highly developed pattern recognition. Those who have never faced a negative outcome have a critical gap in the body of experience that intuition is based on. Many venture capitalists won't invest in a new enterprise if the founder has never undergone failure.

Microsoft's successful entrant in the game business, the Xbox 360, was developed by a team that had worked on 3DO's failed game console, the unsuccessful WebTV, Apple's problematic video card business, and Microsoft's own short-lived UltimateTV. Having been through so many disappointments, the team members were able to spot warning signs and make smart course corrections. For example, the earlier Xbox had used expensive chips from outside manufacturers, and it reportedly lost about $4 billion from 2001 to 2005. The Xbox 360 team chose different manufacturers, worked in close partnership with them to develop the chips, and retained intellectual property rights to the chips, allowing the system to generate profits very early on.

Many venture capitalists won't invest in a new enterprise if the founder has never undergone failure.

Putting Intelligent Failure to Work

Obviously, not all failures are useful, and even some that we could learn from should be avoided at all costs. But if you accept that failures will sometimes occur in uncertain environments, it makes sense to plan for, manage, and learn from them—and in many cases to consider them experiments rather than failures. Here are seven principles that can help your organization leverage learning from failure.

PRINCIPLE 1

Decide what success and failure would look like *before* you launch an initiative.

It never ceases to amaze me how often people working on the same project have entirely different views of what would constitute success. In one case I studied, an organization that made environmental remediation equipment was hoping to introduce a new product line. The marketing group thought the equipment's selling point was that it met a tough new regulatory standard. The engineering group thought the point was cost-effectiveness—and to keep costs down, it was designing out the very features the marketing group wanted to sell. This gap in understanding could easily have led to a failure of the unintelligent variety. But the company found out about it in time to get everyone on the same page and prevent what could have been a marketplace disaster.

PRINCIPLE 2

Convert assumptions into knowledge.

When you're tackling a fundamentally uncertain task, your initial assumptions are almost certain to be incorrect. Often the only way to arrive at better ones is to try things out. But you shouldn't start experimenting until you've made your assumptions explicit. Write them down and share them with your team. Then make sure that you and your team are open to revising them as new information comes in. The risk is that we all have a tendency to gravitate toward information that confirms what we already believe—it's called confirmation bias. A practical way to address this bias is to empower one of your team members to seek out information that suggests your course of action is flawed. You want to find disconfirming information early, before you've made



CONNECT WITH THE AUTHORS Do you have questions or comments about this article? Rita Gunther McGrath will respond to feedback at **hbr.org**.

extensive commitments and become resistant to changing your mind.

Organizations that don't record their assumptions tend to run into two big problems. First, assumptions become converted into facts in people's minds. During a meeting, a manager might venture a guess that a given market could generate $5 million in sales—and before the meeting ends, the $5 million is baked into next year's budget! This sort of leap causes all kinds of dysfunctional behavior when the guess, almost inevitably, turns out to be wrong. Second, such organizations don't learn as much as they could. They may right their course as they proceed, learning as they go, but if they're not rigorous about comparing results with expectations, the lessons won't be explicit and shared, and future projects won't benefit from them.

Having spelled out and revised your assumptions, you should then design the organizational equivalent of an experiment to test them. As with a scientific experiment, the idea is that whether or not the outcome is what you'd hoped for, at least you will have learned something.

PRINCIPLE

Be quick about it—fail fast.

Quick, decisive failures have a number of important benefits. First, they can save you from throwing additional resources at a losing proposition. Second, it's much easier to establish cause and effect when actions and outcomes are close together in time. Third, the sooner you can rule out a given course of action, the faster you will move toward your goal. And finally, an early failure lessens the pressure to continue with the project regardless, because your investment in it is not large.

A practical way to help ensure that any failure happens quickly is to test elements of your project early on. This is the main reason that "agile software development" often produces better results than the more conventional sequential process of systems design. In an agile environment, small chunks of code are written and shared in a quick, iterative fashion with other programmers and users before the team moves on. This is in sharp contrast to the approach in which analysts spend months documenting user requirements before submitting those requirements to programmers, who only then begin coding. By the time a problem is discovered, a project could have been heading in the wrong direction for years.

Speed may require changing how you allocate resources. Instead of going for maximum NPV over a project's lifetime, for example, you may want to break the financial evaluation into smaller chunks in terms of both money and time. You may also want to invest in more-flexible assets and people until you have learned enough to confidently build a significant operation.

And the human benefits of failing fast should not be overlooked. If people feel that a project's failure

We Won't Punish Failure

Here are one UK-based global retailer's formalized rules for when failure is acceptable.

- The effort involves genuine uncertainty.
- The outcome will be decisive, because we planned carefully.
- It's riskier to do nothing—or to conduct further analysis—than to act and fail.
- The cost is small.
- The major underlying assumptions are documented in writing.
- There is a plan to test the assumptions.
- The risks of failing are understood and, to the extent possible, mitigated.
- The cost is contained.
- Commitments are scaled according to our increasing understanding.
- We've defined what success would look like—and the opportunity is significant.



FOCUS ON FAILURE

POSTER
WPA Federal Art Project, circa 1936



will doom them to months of waiting for another project, or to losing their jobs, then failure is demoralizing. But if lots is going on and the conclusion of one effort means that they'll immediately get put on another (possibly more interesting) project, then endings can be positive. At the technical consultancy Sagentia, for example, employees are quick to move from project to project. The finance director, Neil Elton, told me, "They'll proactively send around e-mails with a mini CV, saying, 'I was going to be busy, now I'm not. Can you use my skills?'" This attitude is symptomatic of an organization that knows how to experiment intelligently.

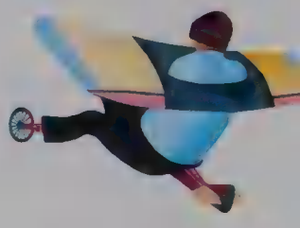
PRINCIPLE 4

Contain the downside risk—fail cheaply.

This is an important corollary to failing fast. Initiatives should be designed to make the consequences of failure modest. Sometimes it's valuable to test a small-scale prototype before making a significant investment. When the Japanese cosmetics firm Kao was considering going into the manufacture of floppy disks, a big question was whether or not customers would buy Kao-branded disks. So the company went to another manufacturer and bought disks that met its quality standards, put the Kao label on them, and offered them to customers. The response was positive, so the plan moved forward. Had the response been negative, Kao could have stopped the project without incurring substantial costs.

This approach may require breaking ingrained habits. The chief innovation officer of a highly technical company I worked with observed that the company would typically get "some guy in a white lab coat" to do a technical feasibility study before deciding whether to enter a new product area. Such studies are not only expensive—upward of $200,000—but also relatively unindicative of business feasibility. So the innovation officer started making mock-ups of potential new products and showing them to prospective customers. In many instances the company learned that nontechnical issues, such as form factor, usability, and fit with existing systems, would have prevented customers from adopting a product. The difference in cost between the approaches was an order of magnitude: A typical mock-up cost around $20,000. The difference in speed was also considerable: a few weeks rather than nine to 12 months.

3M's reputation for being failure tolerant took a beating under former CEO Jim McNerney, a GE-trained leader who sought to utilize Six Sigma quality practices throughout the company, even in its research labs. Although these worked wonders in 3M's factories, the emphasis on generating predictable results hampered employees' willingness to take risks on unproven ideas. When George Buckley took the reins as CEO, in 2005, part of his challenge was to restore the culture of risk taking. He discontinued the use of Six Sigma in the labs and spurred scientists and researchers to pursue new ideas—provided that the downside was small. During the recession, 3M's historical philosophy of "make a little, sell a little" when introducing a new product was successfully coupled with Buckley's emphasis on bottom-of-the-pyramid innovations—inexpensive items that could appeal to very broad markets.



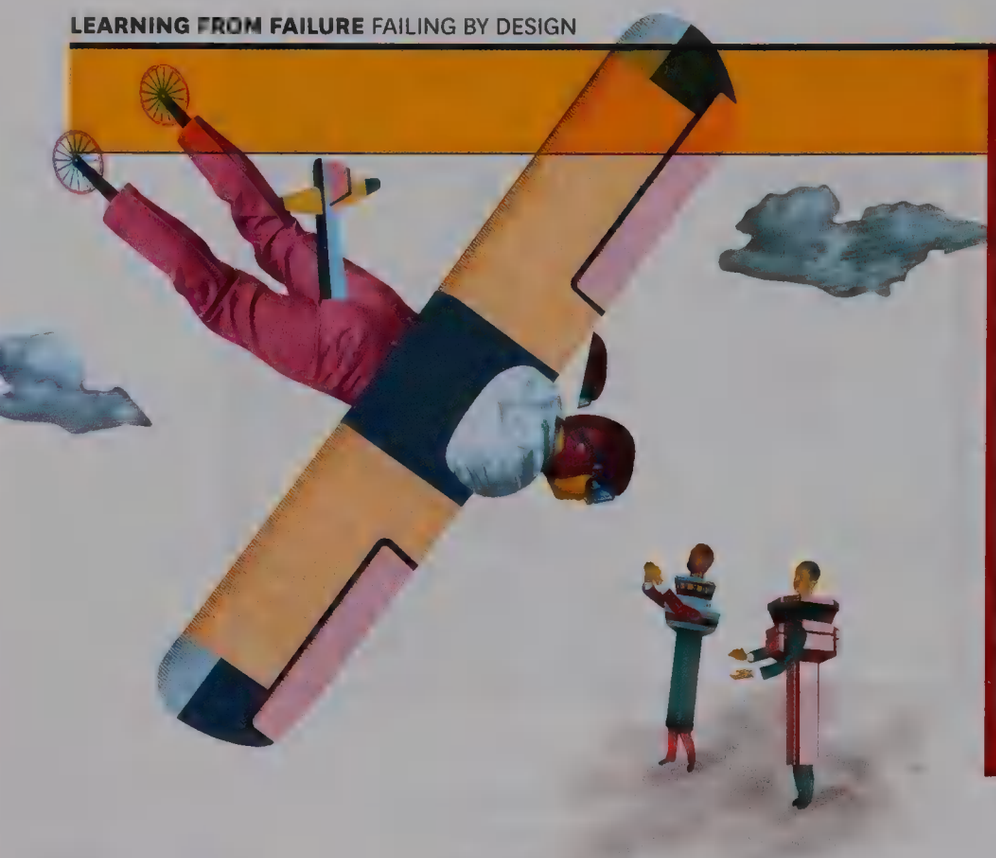


PRINCIPLE 5

Limit the uncertainty.

There isn't much point to encouraging failure in an arena your organization is already familiar with. But experiencing it in an arena completely divorced from your current capabilities won't do you much good either: You probably won't be able to use what you find out, because you won't understand the context and you won't know how to connect what you've learned to your existing knowledge base.

Google, which is ordinarily very good at experimentation, went too far afield when it tried to launch a non-internet radio venture. The company wanted to automate the pricing of radio ads, as it had with internet ads. Radio stations would give Google a portion (ideally all) of their ad inventory, and Google would pit advertisers against one another to bid for the spots. Problems emerged, however, because stations were reluctant to give over control. Worse, the Google ads went for less than those sold directly by the



FOCUS ON FAILURE

FAILURE, INC.

FAIL Blog, a website devoted to pictures and videos of embarrassing **public failures**, launched in January 2008. Its "**epic fail**" meme took off, and the site was **sold within five months, went on to win two Webby awards** in 2009, and spawned a book.

During performance reviews one division leader would say, "Show me your scrap heap." All high achievers try some things that don't work out.

stations, and although Google argued that increased demand would eventually drive up the auction prices, stations were unwilling to take the chance. Media buyers, for their part, were reluctant to engage with Google, which refused to continue the conventional practices of negotiating prices ahead of time and bundling ads together. After shuttering the business, in 2009, CEO Eric Schmidt attributed its failure to the company's inability to measure an ad's performance on the radio—something it could do on the web by tracking views and clicks. The venture cost the company well over $100 million. That's not a lot of money in Google's world; the more important point is that relatively little useful learning seems to have occurred. The chasm between Google's core business and the radio business proved just too great.

It's wise to minimize the number of uncertainties that need to be resolved at any particular decision point. One way to do this is through what Chris Zook, of Bain, calls adjacencies. For example, you can introduce an existing product in a new market: IKEA sells essentially the same furniture in many different countries. You can offer your customers a new but related product: Wells Fargo has had a lot of success cross-selling. Or you can build a new business on the foundation of an existing capability: Air Products and Chemicals has done this with its plant management capabilities. The point is to learn from failure (and leverage success) in areas that are fairly close to your established activities. Zook says that the number of major uncertainties should be exactly one. That's a little extreme. I suggest limiting major uncertainties to those that relate either to the market (pricing, acceptance, form factor, and so forth) or to technology and capability issues (standards, scalability, availability of talent, and so forth)—not taking on uncertainties in both dimensions at once.

Another way to experiment without going too far afield is to break a long-term project up into smaller pieces. Consider the commercialization of nanotechnology: Eventually we'll be able to construct objects at the level of individual molecules, which will be a truly revolutionary change. But that future is likely to be a long time coming. So for the time being, how are we using nanotechnology? Think wrinkle-free Dockers pants. Think cell phone displays that don't show fingerprints. Those more modest projects make a lot of sense: They apply brand-new technology to familiar products, which fosters learning.

PRINCIPLE 6

Build a culture that celebrates intelligent failure.

People often fear that their career prospects will be in trouble if something goes wrong on their watch. (And, of course, they're often right!) Senior managers need to create a climate that encourages intelligent risk taking and doesn't punish any failures that result. Some companies have found it useful to codify this principle. (See the sidebar "We Won't Punish Failure.")

This is an area where CEOs can show strong leadership. A.G. Lafley made fearlessness in the face of failure a core tenet of his time at Procter & Gamble. He said repeatedly that a very high success rate is a sign of incremental innovation, and that he was looking for breakthroughs instead. In his book *The Game-Changer,* published while he was still CEO, he lists and even celebrates his 11 most expensive product failures, focusing on what the company learned

from each. The reasons he gives for the failures range from "required significant consumer habit change" (an at-home dry-cleaning kit) to "small idea" (several new laundry detergents).

That kind of culture building should happen at all levels of the organization. One senior division head I worked with would say to his team members during their performance reviews, "Show me your scrap heap." The request perfectly conveys the idea that high achievers will, of necessity, try some things that don't work out.

PRINCIPLE 7

Codify and share what you learn.

An intelligent failure whose lessons are not shared is worth far less than one that teaches something to the group or, ideally, the whole organization. There are many ways to capture and transfer learning. Among the most popular are mini postmortems as a project proceeds, checkpoint reviews as key thresholds are reached, and after-action review meetings at the project's conclusion. In each case the point is to identify what the assumptions were going in, what happened, what that implies for those assumptions, and what should be done next. It is critical to avoid finger-pointing—restraint that is easier to exercise when the underlying ideas are labeled "assumptions" rather than "projections" or "data."

I recently facilitated a postmortem for a large organization struggling with an IT implementation that had gone dreadfully wrong. Before we convened, I interviewed key decision makers and developed a time line showing when critical decisions had been made. We kicked off the meeting with some general observations about why IT systems often go awry; the message was "You are not alone." Next we discussed the core assumptions that had been in place when the project was authorized, some four years earlier; these came as a surprise to the newer members of the team. We then walked through five decisions that had made a big impact on the project's evolution, discussing the assumptions that were held at the time, what we would have done differently, and what had been learned. The day ended with two breakout sessions: one to determine what to do about the current situation, and one to crystallize lessons that could be valuable in other projects and help avoid similar problems in the future. To make sure the learning was transferred, we charged specific individuals with documenting and communicating those lessons.

How to Walk Away from a Project Intelligently

Even companies with a highly disciplined process for beginning new projects seldom have a good one for getting out. **A solid disengagement process includes these steps:**

1. Decide in advance on periodic checkpoints for determining whether to continue.
2. Evaluate the project's upside against the current estimated cost of continuing. If it no longer appears that the project will deliver the returns anticipated at the outset, it may be time to stop.
3. Compare the project with other candidate projects that need resources. If this one looks less attractive than they do, it may be time to stop.
4. Assess whether the project team may be falling prey to escalation pressures.
5. Involve an objective, informed outsider in the decision about whether to continue, instead of leaving it up to project team members.
6. If the decision is made to stop, spell out the reasons clearly.
7. Think through how capabilities and assets developed during the course of the project might be recouped.
8. Identify all who will be affected by the project's termination; draw up a plan to address disappointment or damage they might suffer.
9. Use a symbolic event—a wake, a play, a memorial—to give people closure.
10. Make sure that the people involved get a new, equally interesting opportunity.

LET'S COME back to the point I made at the outset: In an uncertain and volatile world, avoiding failure is not an option. If you accept this premise, the choice before you is simple: Continue to use practices that limit what you can gain from failures—or embrace the concept of intelligent failure, in which learning can create substantial value.

The example set by senior management is crucial. Leaders must be willing to talk about failures and what was learned from them. I've seen organizations use symbolic rituals to celebrate a failure that taught important lessons; this can create an environment in which failures are discussable. Making the ground rules for risk taking explicit, whether in a contract or by other means, can be useful as well. Telling stories about failures past can make people more comfortable talking about failures in progress. And having graceful ways to shut down initiatives and move on makes the inevitable failures much more palatable. Fumbling toward success by learning from failure will differentiate firms that can thrive during uncertainty from those that cannot.

HBR Reprint R1104E

Failure Chronicles



Roger McNamee is a cofounder of the technology investing firm Elevation Partners.

by Roger McNamee, Elevation Partners

We blew our opportunity to change the world.

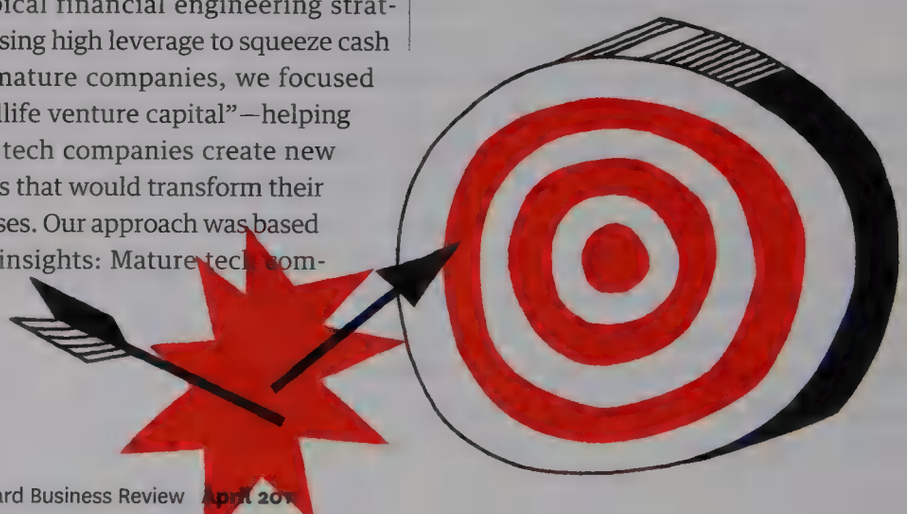
Nearly 30 years of investing in technology companies has exposed me to more kinds of failure than I ever knew existed. For me, the most frustrating is when a company (or person) fails to reach full potential. EBay could have been 10 times as big and 100 times as important as it is today, but shortsighted business plans relegated the company to a very profitable niche.

I was part of a failure like that. In 1997, I realized that the internet bubble was going to end badly for technology investors. I decided to create a new kind of fund that might withstand a market collapse. I began the project, which became Silver Lake Partners, in collaboration with a close friend from the investment banking world. Like eBay, Silver Lake is a very successful firm. And like eBay, we blew our opportunity to change the world.

The idea behind Silver Lake was to create a new kind of private equity. Instead of a typical financial engineering strategy of using high leverage to squeeze cash out of mature companies, we focused on "midlife venture capital"—helping mature tech companies create new products that would transform their businesses. Our approach was based on two insights: Mature tech companies had low valuations, and investors overestimated the cost and complexity of product transformations. At any other time, Silver Lake's radical idea might have scared investors, but in the spring of 1999, institutional investors—state pension plans, in particular—were desperate to put money into the tech sector. It's hard to imagine better circumstances in which to test a new investment strategy.

Silver Lake's first 18 months were bumpy, thanks to the bursting bubble and a team that had never worked together before. Even so, the fund made trailblazing investments, including the buyout of Seagate, the market leader in the hard-drive business, and a large commitment to the online brokerage firm Datek. After our investment, Seagate and Datek embarked on transformational product strategies that led to exceptional financial returns. Their success made Silver Lake a major institution overnight.

Why did we let our vision die? Midlife venture capital turned out to be hard work.



As soon as the first fund was invested, however, Silver Lake abandoned its unique strategy in favor of financial engineering. Limited partners rewarded this reversion to the norm with huge commitments, making Silver Lake's general partners fantastically rich. Sadly, the downside was the end of a pioneering investment strategy that, if widely adopted, might have enabled the United States to compete on a global scale more effectively.

Why did we let our vision die? Midlife venture capital turned out to be hard work. It also did not play to the strengths of some of Silver Lake's partners. We could have sucked it up, like the Rolling Stones, and done the right thing. Instead, we pulled an Everly Brothers and had a big fight that resulted in my leaving the firm.

America has enormous creative energy, but its industries are dominated by lawyers and accountants, not product people. Thirty years of financial engineering and short-term profit optimization has impaired the ability of American companies to innovate. Silver Lake had a chance to change that. We were succeeding. Then we gave up.

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EQUAL HOUSING LENDER



Former Procter & Gamble CEO A.G. Lafley on lessons learned the hard way

Interviewed by Karen Dillon

"I Think of My Failures as a Gift"

HBR: You're widely regarded as one of the most successful CEOs in recent history. But you had your share of mistakes, didn't you?

Lafley: Absolutely. A lot of mistakes and my fair share of failure. But you have to get past the disappointment and the blame and really understand what happened and why it happened. And then, more important, decide what you have learned and what you are going to do differently next time.

How did your failures over the years affect you as a leader?

They were all part of my growth and development. What's the single biggest reason that leaders stop developing and growing? They stop becoming adaptable; they stop becoming agile. It's Darwin's theory. When you stop learning, you stop developing and you stop growing. That's the end of a leader.

Can leaders learn as much from success?

No. My experience is that we learn much more from failure than we do from success. Look at great politicians and successful sports teams. Their biggest lessons come from their toughest losses. The same is true for any kind of leader. And it was certainly true for me.

Can you give me an example of learning from failure at P&G?

We learned much more from failed new brands and products like Dryel at-home dry cleaning and Fit Fruit & Vegetable Wash than we did from huge successes like Febreze and Swiffer.



A.G. Lafley is the former chairman and chief executive officer of Procter & Gamble.

This is one of my favorites: In the 1980s P&G tried to get into the bleach business. We had a differentiated and superior product—a color-safe low-temperature bleach. We created a brand called Vibrant. We went to test-market in Portland, Maine.

Why Maine?

We thought the test market was so far from Oakland, California, where Clorox was headquartered, that maybe we could fly under the radar there. So we went in with what we thought was a winning launch plan: full retail distribution, heavy sampling and couponing, and major TV advertising. All designed to drive high consumer awareness and trial of a new bleach brand and a better bleach product.

And then?

Do you know what Clorox did? They gave every household in Portland, Maine, a free gallon of Clorox bleach—delivered to the front door. Game, set, match to Clorox. We'd already bought all the advertising. We'd spent most of the launch money on sampling and couponing. And nobody in Portland, Maine, was going to need bleach for several months. I think they even gave consumers a $1 off coupon for the next gallon. They basically sent us a message that said, "Don't ever think about entering the bleach category."

How did you rebound from that setback?

We certainly learned how to defend leading brand franchises. When Clorox tried to enter the laundry detergent business a few years later, we sent them a similarly clear and direct message—and they ultimately withdrew their entry. More important, I learned what worked and was salvageable from that bleach failure: P&G's low-temperature, color-safe technology. We modified the technology and put it into a laundry detergent, which we introduced as Tide with Bleach. At its peak, Tide with Bleach was a more than half-billion-dollar business.

Consumers still use both bleach additives and detergents with bleach. So it ended up being a win-win for consumers, retailers, and manufacturers. It created more category consumption, a better at-home cleaning experience, and a better value proposition for all concerned. But we learned that head-on, World War I–like assaults on walled cities generally end with a lot of casualties.

How did you use failure as a tool?

Many CEOs—including me—use innovation and acquisition to grow organically and inorganically in a balanced and sustained way. Both innovation and acquisition are risky and have high failure rates: 80% plus for new product innovation in our industry; 70% plus for acquisition. So I had a team at P&G do a detailed analysis of all our acquisitions from 1970 to 2000. And the sobering story was that only 25% to 30% succeeded in that period. "Successful" meant "met or exceeded the investment case and going-in investment objectives." Partial success meant "exceeded the cost of capital." We studied the failures in detail. We pinpointed the problems and discovered patterns in our mistakes.

> It's Darwin's theory. When you stop learning, you stop developing and you stop growing.

Did you discover why P&G failed at acquisitions so often?

Yes—not surprisingly, it's not rocket science. We found five fundamental root causes of failure: (1) The absence of a winning strategy for the combination. (2) Not integrating quickly or well. (3) Expecting synergies that don't materialize. (4) Cultures that aren't compatible. (5) Leadership that wouldn't play together in the same sandbox.

How did that analysis alter things?

Once we had identified the problems, we focused on what we had to change. How should we organize for each phase of the acquisition? What processes should we put in place? What interim measures would tell us whether we were on track or off track? It's just a disciplined process, and you put somebody in charge of each phase of the process.

Can you give me an example of using that process successfully?

When we acquired Gillette, in 2005, which was one of the 10 biggest acquisitions ever, we put a team and a process in place to avoid our past failures. We put Jim Kilts, Gillette's CEO, on P&G's board, and we put him and Clayt Daley, P&G's CFO, jointly in charge of the acquisition integration and value creation. We identified all the value creation elements. We identified the integration sequence and elements. We put a pretty senior manager in charge of every value creation initiative. Bob McDonald, the current CEO, was in charge of integrating global operations. Filippo Passerini was in charge of integrating the back room and IT; Rick Hughes was in charge of integrating all purchasing; and so on. We tracked progress for every value-creating initiative using a simple red, yellow, green process: "We're on track," "We're not on track." And we just drove every phase of the integration, every building block of value creation, to completion.

How do you measure success on that acquisition?

We ended up delivering more than 150% of the originally estimated cost synergies. So the cost synergies alone created enough value to make the Gillette acquisition a success. The revenue synergies, which continue to come in—for example, in oral care we combined the Crest and Oral-B brands and all of our oral care product innovation—all come on top of the cost synergies.

After you started using the new process, how did P&G's track record change?

Knowing what went wrong from 1970 to 2000, we were able to shift our acquisition success rate from below 30% to above 60% over the past 10 years. The whole idea of really studying, really going to school on failures, is so important. Because failures aren't the opposite of success. A lot of people think there's success or there's failure.

Failure is, in my view, all about learning. It's about learning what you can do better.

> We were playing small ball instead of looking at the big picture. Color me naive on that one.

As a result of your new knowledge, was Gillette a perfect case study of incorporating an acquisition?

No, Gillette was not perfect. We conducted ongoing evaluations of every element of the Gillette acquisition. There were a lot of things we could have done differently and better. Especially on the people development and growth front. I personally spent a lot of time trying to ensure that the people on the leadership development list at Gillette got the right kinds of assignments, but we lost a few people we didn't want to lose—and we didn't get every Gillette player in the absolute right position to start out. We will capture those lessons—and apply them to the next one.

Did you ever make a mistake in what you didn't do—rather than in what you did do?

I had some big misses in my 10 years as CEO. I missed two potentially transformational acquisitions: one of a leading global beauty and personal care brand and one of a health care Rx to OTC switch [from a prescription to an over-the-counter brand]. In the first, I had the majority partner on board but couldn't close with the minority partners and lost the deal. In the second, I had a promising discussion with the CEO of the health care division, who was very open to swapping his Rx to OTC product rights for a P&G prescription drug in late-stage development. The CEOs were aligned; the CFOs were working together to get the valuations right for each company and to pin down the terms of the deal. It would have been a terrific deal for P&G.

Why?

When I came into the job, in 2000, we were de facto in the health care business. We were in the prescription drug business, the over-the-counter brand business, and the branded nonregulated health care business. I liked consumer health care, but I was skeptical of the prescription drug business. It isn't a consumer-driven business—doctors write prescriptions, health insurers pay most of the cost. It isn't really a branded business. On top of that, prescription drugs typically took 10 to 15 years to develop—at huge expense—and the lifetime of a prescription drug was limited to, at most, the length of the patent or 14 years. Prescription drugs weren't really in P&G's competitive sweet spot. They didn't match up well with P&G's core strengths.

So I thought we needed to migrate or sell out of the prescription drug business and invest more in

over-the-counter nonregulated consumer brands. A conversation about this was going on with management and with the board when this opportunity came up and we learned that a major drug was going to be switched. Our idea was to trade one of our prescription drugs in the final phase of clinical trials for the drug they were going to switch to OTC. In proposing that switch, I was trying to get some level of commitment from the board and the management team for the strategy I wanted to pursue, which was ultimately to exit the pharmaceutical business. [P&G eventually sold its pharmaceutical business to Warner Chilcott in 2009.]

What went wrong?

At the last minute, the heads of our health care business, the head of R&D, and a prominent board member from the health care industry all surfaced opposition to the deal. And as I thought about it, it was perfectly rational behavior on their part. The leaders of the P&G health care business wanted to keep the assets and businesses that they had—they didn't want to give up one of their promising prescription drugs. The head of R&D had put a lot of time, money, and personal effort into developing the drug we were going to swap. And the prominent board member believed that we had promising prescription drugs in development and that we should see that development through to the end.

So you abandoned the deal?

Yes. And it ended up being a huge mistake. The switch was eventually done by the parent health care company and it turned out to be the third biggest switch from prescription to over-the-counter ever, after Tylenol and Prilosec. So that was just a huge disappointment.

What lesson did you take from that failure?

That the deal really wasn't about the rational business case, it wasn't about strategy, and it wasn't about the economics and financials. Those were all buttoned up and, frankly, pretty attractive. It was about managing the human motivators and human behaviors and the different personalities. I just didn't see this alliance forming between the leaders of the business, the leader of R&D, and one of my more influential directors. This is a case where politics was stronger than economics. A case where the long-term strategic merits really didn't matter; the shorter-term interests of individuals carried the day. We got trapped in a debate about whether P&G's prescription drug or the OTC switch was going to be a bigger and more profitable business—and not whether the prescription drug business was a good strategic fit for P&G. Or even a better strategic fit than other health care and personal care businesses we could have put our cash and talent against. We were playing small ball instead of looking at the big picture. Color me naive on that one.

What did you do differently after that?

After that, I tried with any major decision to think not only about the strategy, economics, and financials and the business case, but also about who was going to be influential in the decision and how I could manage that individual and not ever be caught off guard again.

What advice would you offer other CEOs about learning from failure?

First, some of the most important and insightful learning is far more likely to come from failures than from successes. Second, the learning has to be institutionalized to endure. Otherwise you keep making the same mistakes over and over, and you don't learn from them. That's why we did in-depth analysis of innovation failures and in-depth analysis of acquisition failures. We were forcing ourselves to come to grips with reality and to report to both management and the board annually on the failure rates of these two critical growth drivers. It doesn't do any good for me to learn something personally if the institution doesn't learn the same lessons. You create institutional learning. You create institutional memory.

It's not enough to take responsibility for your failures. It's important to create a culture that turns failures into learning and leads to continual improvement. If the leader of the company doesn't do that, it's very difficult to get the culture right. It's crucial to creating a culture of courage and openness to change and continued improvement.

The topic of failure is very important, and it gets more lip service than good practice. I think I learned more from my failures than from my successes in all my years as a CEO. I think of my failures as a gift. Unless you view them that way, you won't learn from failure, you won't get better—and the company won't get better.

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How to Avoid Catastrophe

Failures happen. But if you pay attention to near misses, you can predict and prevent crises.

by Catherine H. Tinsley, Robin L. Dillon, and Peter M. Madsen

MOST PEOPLE think of "near misses" as harrowing close calls that could have been a lot worse—when a firefighter escapes a burning building moments before it collapses, or when a tornado miraculously veers away from a town in its path. Events like these are rare narrow escapes that leave us shaken and looking for lessons.

But there's another class of near misses, ones that are much more common and pernicious. These are the often unremarked small failures that permeate day-to-day business but cause no immediate harm. People are hardwired to misinterpret or ignore the warnings embedded in these failures, and so they often go unexamined or, perversely, are seen as signs that systems are resilient and things are going well. Yet these seemingly innocuous events are often harbingers; if conditions shift slightly, or if luck does not intervene, a crisis erupts.

Consider the BP Gulf oil rig disaster. As a case study in the anatomy of near misses and the consequences of misreading them, it's close to perfect. In April 2010, a gas blowout occurred during the cementing of the *Deepwater Horizon* well. The blowout ignited, killing 11 people, sinking the rig, and triggering a massive underwater spill that would take months to contain. Numerous poor decisions and dangerous conditions contributed to the disaster: Drillers had used too few centralizers to position the pipe, the lubricating "drilling mud" was removed too early, managers had misinterpreted vital test results that would have confirmed that hydrocarbons were seeping from the well. In addition, BP relied on an older version of a complex fail-safe device called a blowout preventer that had a notoriously spotty track record.

Why did Transocean (the rig's owner), BP executives, rig managers, and the drilling crew overlook the warning signs, even though the well had been plagued by technical problems all along (crew members called it "the well from hell")? We believe that the stakeholders were lulled into complacency by a catalog of previous near misses in the industry—successful outcomes in which luck played a key role in averting disaster. Increasing numbers of ultradeep wells were being drilled, but significant oil spills or fatalities were extremely rare. And many Gulf of Mexico wells had suffered minor blowouts during cementing (dozens of them in the past two decades); however, in each case chance factors—favorable wind direction, no one welding near the leak at the time, for instance—helped prevent an explosion. Each near miss, rather than raise alarms

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FOCUS ON FAILURE



"Every strike brings me closer to the next home run."

BABE RUTH
BASEBALL PLAYER

and prompt investigations, was taken as an indication that existing methods and safety procedures worked.

For the past seven years, we have studied near misses in dozens of companies across industries from telecommunications to automobiles, at NASA, and in lab simulations. Our research reveals a pattern: Multiple near misses preceded (and foreshadowed) every disaster and business crisis we studied, and most of the misses were ignored or misread. Our work also shows that cognitive biases conspire to blind managers to the near misses. Two in particular cloud our judgment. The first is "normalization of deviance," the tendency over time to accept anomalies—particularly risky ones—as normal. Think of the growing comfort a worker might feel with using a ladder with a broken rung; the more times he climbs the dangerous ladder without incident, the safer he feels it is. For an organization, such normalization can be catastrophic. Columbia University sociologist Diane Vaughan coined the phrase in her book *The Challenger Launch Decision* to describe the organizational behaviors that allowed a glaring mechanical anomaly on the space shuttle to gradually be viewed as a normal flight risk—dooming its crew. The second cognitive error is the so-called outcome bias. When people observe successful outcomes, they tend to focus on the results more than on the (often unseen) complex processes that led to them.

Recognizing and learning from near misses isn't simply a matter of paying attention; it actually runs contrary to human nature. In this article, we examine near misses and reveal how companies can detect and learn from them. By seeing them for what they are—instructive failures—managers can apply their lessons to improve operations and, potentially, ward off catastrophe.

Roots of Crises

Consider this revealing experiment: We asked business students, NASA personnel, and space-industry contractors to evaluate a fictional project manager, Chris, who was supervising the launch of an unmanned spacecraft and had made a series of decisions, including skipping the investigation of a potential design flaw and forgoing a peer review, because of time pressure. Each participant was given one of three scenarios: The spacecraft launched without issue and was able to transmit data (success outcome); shortly after launch, the spacecraft had a problem caused by the design flaw, but because of the way the sun happened to be aligned with the vehicle it was still able to transmit data (near-miss outcome); or the craft had a problem caused by the flaw and, because of the sun's chance alignment, it failed to transmit data and was lost (failure outcome).

How did Chris fare? Participants were just as likely to praise his decision making, leadership abilities, and the overall mission in the success case as in the near-miss case—though the latter plainly succeeded only because of blind luck. When people observe a successful outcome, their natural tendency is to assume that the process that led to it was fundamentally sound, even when it demonstrably wasn't; hence the common phrase "you can't argue with success." In fact, you can—and should.

Organizational disasters, studies show, rarely have a single cause. Rather, they are initiated by the unexpected interaction of multiple small, often seemingly unimportant, human errors, technological failures, or bad business decisions. These latent errors combine with enabling conditions to produce a significant failure. A latent error on an oil rig might be a cementing procedure that allows gas to escape; enabling conditions might be a windless day and a welder working near the leak. Together, the latent error and enabling conditions ignite a deadly firestorm. Near misses arise from the same preconditions, but in the absence of enabling conditions, they produce only small failures and thus go undetected or are ignored.

Latent errors often exist for long periods of time before they combine with enabling conditions to produce a significant failure. Whether an enabling condition transforms a near miss into a crisis generally depends on chance; thus, it makes little sense to try to predict or control enabling conditions. Instead, companies should focus on identifying and fixing la-

PHOTOGRAPHY: GETTY IMAGES

Idea in Brief

Most business failures, such as engineering disasters, product malfunctions, and PR crises, **are preceded by near misses**—close calls that, had it not been for chance, would have been worse.

Managers often misinterpret these warning signs because they are blinded by cognitive biases. They take the near misses as indications that systems are working well—or they don't notice them at all.

Seven strategies can help managers recognize and learn from near misses. Managers should: (1) be on alert when time or cost pressures are high; (2) watch for deviations from the norm; (3) uncover the deviations' root causes; (4) hold themselves accountable for near misses; (5) envision worst-case scenarios; (6) look for near misses masquerading as successes; and (7) reward individuals for exposing near misses.

tent errors before circumstances allow them to create a crisis.

Oil rig explosions offer a dramatic case in point, but latent errors and enabling conditions in business often combine to produce less spectacular but still costly crises—corporate failures that attention to latent errors could have prevented. Let's look at three.

Bad Apple. Take Apple's experience following its launch of the iPhone 4, in June 2010. Almost immediately, customers began complaining about dropped calls and poor signal strength. Apple's initial response was to blame users for holding the phone the wrong way, thus covering the external antenna, and to advise them to "avoid gripping [the phone] in the lower left corner." When questioned about the problem by a user on a web forum, CEO Steve Jobs fired back an e-mail describing the dropped calls as a "non issue." Many customers found Apple's posture arrogant and insulting and made their displeasure known through social and mainstream media. Several filed class action lawsuits, including a suit that alleged "fraud by concealment, negligence, intentional misrepresentation and defective design." The reputation crisis reached a crescendo in mid-July, when *Consumer Reports* declined to recommend the iPhone 4 (it had recommended all previous versions). Ultimately Apple backpedaled, acknowledging software errors and offering owners software updates and iPhone cases to address the antenna problem.

The latent errors underlying the crisis had long been present. As Jobs demonstrated during a press conference, virtually all smartphones experience a drop in signal strength when users touch the external antenna. This flaw had existed in earlier iPhones, as well as in competitors' phones, for years. The phones' signal strength problem was also well known. Other latent errors emerged as the crisis gained momentum, notably an evasive PR strategy that invited a backlash.

That consumers had endured the performance issues for years without significant comment was not a sign of a successful strategy but of an ongoing near miss. When coupled with the right enabling conditions—*Consumer Reports'* withering and widely quoted review and the expanding reach of social media—a crisis erupted. If Apple had recognized consumers' forbearance as an ongoing near miss and proactively fixed the phones' technical problems, it could have avoided the crisis. It didn't, we suspect, because of normalization bias, which made the antenna glitch seem increasingly acceptable; and because of outcome bias, which led managers to conclude that the lack of outcry about the phones' shortcomings reflected their own good strategy—rather than good luck.

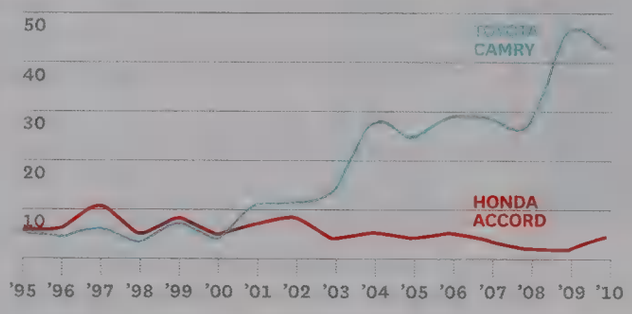
Speed Warning. On August 28, 2009, California Highway Patrol officer Mark Saylor and three family members died in a fiery crash after the gas pedal of the Lexus sedan they were driving in stuck, accelerating the car to more than 120 miles per hour. A 911 call from the speeding car captured the horrifying moments before the crash and was replayed widely in the news and social media.

Consumers' enduring the iPhone's problems for years without comment was a sign not of a solid strategy but of an ongoing near miss.

Errors in process or product design are often ignored, even when the warning signs clearly call for action. The more times small failures occur without disaster, the more complacent managers become.

Toyota Pedal Problems

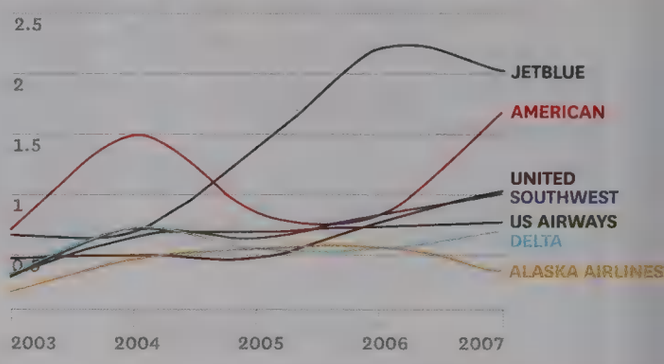
PERCENTAGE OF CUSTOMER COMPLAINTS HAVING TO DO WITH SPEED CONTROL



SOURCE NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION

JetBlue Tarmac Trouble

WEATHER DELAYS OF TWO HOURS OR MORE PER 1,000 FLIGHTS



SOURCE DEPARTMENT OF TRANSPORTATION'S BUREAU OF TRANSPORTATION STATISTICS

Up to this point, Toyota, which makes Lexus, had downplayed the more than 2,000 complaints of unintended acceleration among its cars it had received since 2001. The Saylor tragedy forced the company to seriously investigate the problem. Ultimately, Toyota recalled more than 6 million vehicles in late 2009 and early 2010 and temporarily halted production and sales of eight models, sustaining an estimated $2 billion loss in North American sales alone and immeasurable harm to its reputation.

Complaints about vehicle acceleration and speed control are common for all automakers, and in most cases, according to the National Highway Traffic Safety Administration, the problems are caused by driver error, not a vehicle defect. However, beginning in 2001, about the time that Toyota introduced a new accelerator design, complaints of acceleration problems in Toyotas increased sharply, whereas such complaints remained relatively constant for other automakers (see the exhibit "Toyota Pedal Problems"). Toyota could have averted the crisis if it had noted this deviation and acknowledged the thousands of complaints for what they were—near misses. Here, too, normalization of deviance and outcome bias, along with other factors, conspired to obscure the grave implications of the near misses. Only when an enabling condition occurred—the Saylor family tragedy and the ensuing media storm—did the latent error trigger a crisis.

Jet Black and Blue. Since it began operating, in 2000, JetBlue Airways has taken an aggressive approach to bad weather, canceling proportionately fewer flights than other airlines and directing its pilots to pull away from gates as soon as possible in severe weather so as to be near the front of the line when runways were cleared for takeoff—even if that meant loaded planes would sit for some time on the tarmac. For several years, this policy seemed to work. On-tarmac delays were not arduously long, and customers were by and large accepting of them. Nonetheless, it was a risky strategy, exposing the airline to the danger of stranding passengers for extended periods if conditions abruptly worsened.

The wake-up call came on February 14, 2007. A massive ice storm at New York's John F. Kennedy International Airport caused widespread disruption—but no carrier was harder hit than JetBlue, whose assertive pilots now found themselves stuck on the tarmac (literally, in some cases, because of frozen wheels) and with no open gates to return to. Distressed passengers on several planes were trapped for up to 11 hours in overheated, foul-smelling cabins with little food or water. The media served up angry first-person accounts of the ordeal, and a chastened David Neeleman, JetBlue's CEO, acknowledged on CNBC, "We did a horrible job, actually, of getting our customers off those airplanes." The airline reported canceling more than 250 of its 505 flights that day—a much higher proportion than any other airline. It lost millions of dollars and squandered priceless consumer loyalty.

For JetBlue, each of the thousands of flights that took off before the competition during previous weather delays was a near miss. As the airline continued to get away with the risky strategy, managers who had expressed concern early on about the way the airline handled flight delays became complacent, even as long delays mounted. Indeed, the proportion of JetBlue weather-based delays of two hours or more roughly tripled between 2003 and 2007, whereas such delays remained fairly steady at other major U.S. airlines (see the exhibit "JetBlue Tarmac Trouble").

Rather than perceiving that a dramatic increase in delays represented a dramatic increase in risk, JetBlue managers saw only successfully launched flights. It took an enabling condition—the ferocious ice storm—to turn the latent error into a crisis.

Recognizing and Preventing Near Misses

Our research suggests seven strategies that can help organizations recognize near misses and root out the latent errors behind them. We have developed many of these strategies in collaboration with NASA—an organization that was initially slow to recognize the relevance of near misses but is now developing enterprisewide programs to identify, learn from, and prevent them.

1 Heed High Pressure. The greater the pressure to meet performance goals such as tight schedules, cost, or production targets, the more likely managers are to discount near-miss signals or misread them as signs of sound decision making. BP's managers knew the company was incurring overrun costs of $1 million a day in rig lease and contractor fees, which surely contributed to their failure to recognize warning signs.

The high-pressure effect also contributed to the *Columbia* space shuttle disaster, in which insulation foam falling from the external fuel tank damaged the shuttle's wing during liftoff, causing the shuttle to break apart as it reentered the atmosphere. Managers had been aware of the foam issue since the start of the shuttle program and were concerned about it early on, but as dozens of flights proceeded without serious mishap, they began to classify foam strikes as maintenance issues—rather than as near misses. This classic case of normalization of deviance was exacerbated by the enormous political pressure the agency was under at the time to complete the International Space Station's main core. Delays on the shuttle, managers knew, would slow down the space station project.

Despite renewed concern about foam strikes caused by a particularly dramatic recent near miss, and with an investigation under way, the *Columbia* took off. According to the Columbia Accident Investigation Board, "The pressure of maintaining the flight schedule created a management atmosphere that increasingly accepted less-than-specification performance of various components and systems."

When people make decisions under pressure, psychological research shows, they tend to rely on heuristics, or rules of thumb, and thus are more easily influenced by biases. In high-pressure work environments, managers should expect people to be more easily swayed by outcome bias, more likely to normalize deviance, and more apt to believe that their decisions are sound. Organizations should encourage, or even require, employees to examine their decisions during pressure-filled periods and ask, "If I had more time and resources, would I make the same decision?"

2 Learn from Deviations. As the Toyota and JetBlue crises suggest, managers' response when some aspect of operations skews from the norm is often to recalibrate what they consider acceptable risk. Our research shows that in such cases, decision makers may clearly understand the statistical risk represented by the deviation, but grow increasingly less concerned about it.

We've seen this effect clearly in a laboratory setting. Turning again to the space program for insight, we asked study participants to assume operational control of a Mars rover in a simulated mission. Each morning they received a weather report and had to decide whether or not to drive onward. On the second day, they learned that there was a 95% chance of a severe sandstorm, which had a 40% chance of causing catastrophic wheel failure. Half the participants were told that the rover had successfully driven through sandstorms in the past (that is, it had emerged unscathed in several prior near misses); the other half had no information about the rover's luck in past storms. When the time came to choose whether or not to risk the drive, three quarters of the near-miss group opted to continue driving; only 13% of the other group did. Both groups knew, and indeed stated that they knew, that the risk of failure was 40%—but the near-miss group was much more comfortable with that level of risk.

Managers should seek out operational deviations from the norm and examine whether their reasons for tolerating the associated risk have merit. Questions to ask might be: Have we always been comfortable with this level of risk? Has our policy toward this risk changed over time?

3 Uncover Root Causes. When managers identify deviations, their reflex is often to correct the symptom rather than its cause. Such was Apple's response when it at first suggested that customers address the antenna problem by changing the way they held the iPhone. NASA learned this lesson the



hard way as well, during its 1998 Mars Climate Orbiter mission. As the spacecraft headed toward Mars it drifted slightly off course four times; each time, managers made small trajectory adjustments, but they didn't investigate the cause of the drifting. As the $200 million spacecraft approached Mars, instead of entering into orbit, it disintegrated in the atmosphere. Only then did NASA uncover the latent error—programmers had used English rather than metric units in their software coding. The course corrections addressed the symptom of the problem but not the underlying cause. Their apparent success lulled decision makers into thinking that the issue had been adequately resolved.

The health care industry has made great strides in learning from near misses and offers a model for others. Providers are increasingly encouraged to report mistakes and near misses so that the lessons can be teased out and applied. An article in *Today's Hospitalist,* for example, describes a near miss at Delnor-Community Hospital, in Geneva, Illinois. Two patients sharing a hospital room had similar last names and were prescribed drugs with similar-sounding names—Cytotec and Cytoxan. Confused by the similarities, a nurse nearly administered one of the drugs to the wrong patient. Luckily, she caught her mistake in time and filed a report detailing the close call. The hospital immediately separated the patients and created a policy to prevent patients with similar names from sharing rooms in the future.

Little Near Misses and Small-Scale Failures

We've used dramatic cases such as oil spills and shuttle disasters to illustrate how near misses can foreshadow huge calamities.

But near misses are relevant to managers at all levels in their day-to-day work, as they can also presage lesser but still consequential problems. Research on workplace safety, for example, estimates that for every 1,000 near misses, one accident results in a serious injury or fatality, at least 10 smaller accidents cause minor injuries, and 30 cause property damage but no injury. Identifying near misses and addressing the latent errors that give rise to them can head off the even the more mundane problems that distract organizations and sap their resources.

Imagine an associate who misses deadlines and is chronically late for client meetings but is otherwise a high performer. Each tardy project and late arrival is a near miss; but by addressing the symptoms of the problem—covering for the employee in a variety of ways—his manager is able to prevent clients from defecting. By doing this, however, she permits a small but significant erosion of client satisfaction, team cohesiveness, and organizational performance. And eventually, a client may jump ship—an outcome that could have been avoided by attending to the near misses. Your organization needn't face a threat as serious as an oil spill to benefit from exposing near misses of all types and addressing their root causes.

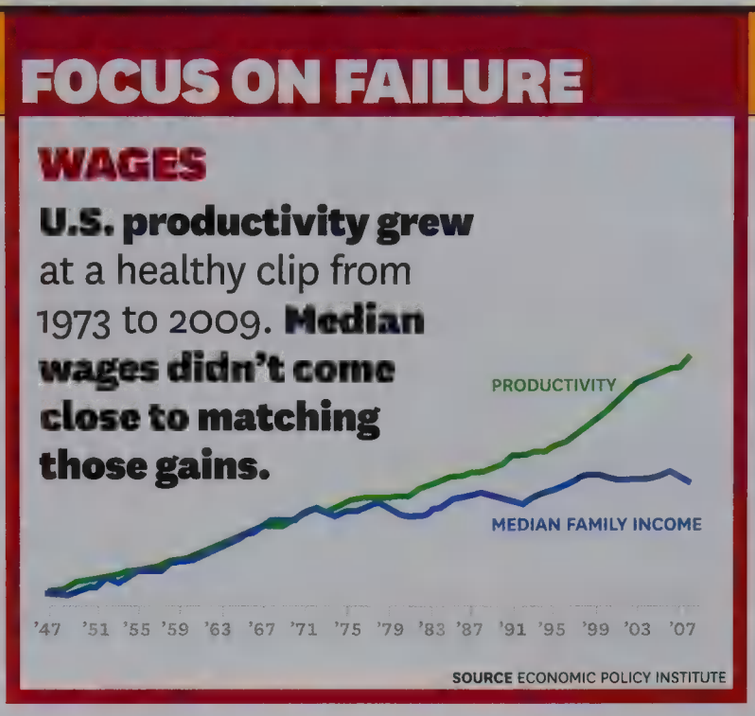
4 Demand Accountability. Even when people are aware of near misses, they tend to downgrade their importance. One way to limit this potentially dangerous effect is to require managers to justify their assessments of near misses.

Remember Chris, the fictional manager in our study who neglected some due diligence in his supervision of a space mission? Participants gave him equally good marks for the success scenario and the near-miss scenario. Chris's raters didn't seem to see that the near miss was in fact a near disaster. In a continuation of that study, we told a separate group of managers and contractors that they would have to justify their assessment of Chris to upper management. Knowing they'd have to explain their rating to the bosses, those evaluating the near-miss scenario judged Chris's performance just as harshly as did those who had learned the mission had failed—recognizing, it seems, that rather than managing well, he'd simply dodged a bullet.

5 Consider Worst-Case Scenarios. Unless expressly advised to do so, people tend not to think through the possible negative consequences of near misses. Apple managers, for example, were aware of the iPhone's antenna problems but probably hadn't imagined how bad a consumer backlash could get. If they had considered a worst-case scenario, they might have headed off the crisis, our research suggests.

In one study, we told participants to suppose that an impending hurricane had a 30% chance of hitting their house and asked them if they would evacuate. Just as in our Mars rover study, people who were told that they'd escaped disaster in previous near misses were more likely to take a chance (in this case, opting to stay home). However, when we told participants to suppose that, although their house had survived previous hurricanes, a neighbor's house had been hit by a tree during one, they saw things differently; this group was far more likely to evacuate. Examining events closely helps people distinguish between near misses and successes, and they'll often adjust their decision making accordingly.

FOCUS ON FAILURE



Managers in Walmart's business-continuity office clearly understand this. For several years prior to Hurricane Katrina, the office had carefully evaluated previous hurricane near misses of its stores and infrastructure and, based on them, planned for a direct hit to a metro area where it had a large presence. In the days before Katrina made landfall in Louisiana, the company expanded the staff of its emergency command center from the usual six to 10 people to more than 50, and stockpiled food, water, and emergency supplies in its local warehouses. Having learned from prior near misses, Walmart famously outperformed local and federal officials in responding to the disaster. Said Jefferson Parish sheriff Harry Lee, "If the American government had responded like Walmart has responded, we wouldn't be in this crisis."

6 Evaluate Projects at Every Stage. When things go badly, managers commonly conduct postmortems to determine causes and prevent recurrences. When they go well, however, few do formal reviews of the success to capture its lessons. Because near misses can look like successes, they often escape scrutiny.

The chief knowledge officer at NASA's Goddard Space Flight Center, Edward Rogers, instituted a "pause and learn" process in which teams discuss at each project milestone what they have learned. They not only cover mishaps but also expressly examine perceived successes and the design decisions considered along the way. By critically examining projects while they're under way, teams avoid outcome bias and are more likely to see near misses for what they are. These sessions are followed by knowledge-sharing workshops involving a broader group of teams. Other NASA centers, including the Jet Propulsion Laboratory, which manages NASA's Mars program, are beginning similar experiments. According to Rogers, most projects that have used the pause-and-learn process have uncovered near misses—typically, design flaws that had gone undetected. "Almost every mishap at NASA can be traced to some series of small signals that went unnoticed at the critical moment," he says.

7 Reward Owning Up. Seeing and attending to near misses requires organizational alertness, but no amount of attention will avert failure if people aren't motivated to expose near misses—or, worse, are discouraged from doing so. In many organizations, employees have reason to keep quiet about failures, and in that type of environment they're likely to keep suspicions about near misses to themselves.

Political scientists Martin Landau and Donald Chisholm described one such case that, though it took place on the deck of a warship, is relevant to any organization. An enlisted seaman on an aircraft carrier discovered during a combat exercise that he'd lost a tool on the deck. He knew that an errant tool could cause a catastrophe if it were sucked into a jet engine, and he was also aware that admitting the mistake could bring a halt to the exercise—and potential punishment. As long as the tool was unaccounted for, each successful takeoff and landing would be a near miss, a lucky outcome. He reported the mistake, the exercise was stopped, and all aircraft aloft were redirected to bases on land, at a significant cost.

Rather than being punished for his error, the seaman was commended by his commanding officer in a formal ceremony for his bravery in reporting it. Leaders in any organization should publicly reward staff for uncovering near misses—including their own.

TWO FORCES conspire to make learning from near misses difficult: Cognitive biases make them hard to see, and, even when they are visible, leaders tend not to grasp their significance. Thus, organizations often fail to expose and correct latent errors even when the cost of doing so is small—and so they miss opportunities for organizational improvement before disaster strikes. This tendency is itself a type of organizational failure—a failure to learn from "cheap" data. Surfacing near misses and correcting root causes is one the soundest investments an organization can make.

HBR Reprint R1104G

Failure Chronicles

Wayne Pacelle is the president and CEO of the Humane Society of the United States and author of *The Bond: Our Kinship with Animals, Our Call to Defend Them* (William Morrow, 2011).

by Wayne Pacelle, Humane Society

I hadn't factored in pressure from the lobbyists.



In October 2001, the Humane Society of the United States scored a big victory for animal welfare and food safety. We persuaded a majority in both chambers of Congress to include in the current farm bill a ban on the slaughter of "downer" cows—animals too sick or injured to walk—for human consumption. I'd led the charge on this campaign, and it was a proud moment for me.

Weeks later, however, a conference committee charged with reconciling the House and Senate versions of the bill gutted our provision, despite the fact that the two contained nearly identical language. A handful of lawmakers sympathetic to the cattle industry did their handiwork behind closed doors and got the best of us. I had badly underestimated their power and failed to win them over, even though they were the ones we needed most.

In 2003, we tried again, and I was confident we had the votes to win in the House. But agriculture lobbyists mounted a fierce campaign against us, and we lost, 199 to 203. We'd have won by flipping just three "no" votes to our side. It was especially painful that two of the votes against us had come from devoted Humane Society allies who happened to represent rural constituencies. I'd assumed they understood the issue, but I hadn't factored in the pressure they'd feel from farm lobbyists. I'd worked hard but still left too much to chance.

Political sentiment seemed to change six months later, when BSE, or mad cow disease, was found in a downer cow in Washington state. Almost overnight, 50 countries closed their markets to U.S. beef, and many Americans stopped buying the beef, too. Eventually, Ann Veneman, the U.S. secretary of agriculture, was forced to issue a dramatic announcement banning the slaughter of downer cows.

But still it wasn't over. Unbeknownst to the Humane Society, the cattle industry and the USDA worked quietly in the months and years ahead to weaken implementation of the ban, allowing some of these animals into the food supply again. It took one of our undercover investigations in 2008 to discover that workers at a meatpacking plant were tormenting downer cows to get them to move into the slaughter area. Again the nation was shocked, and 143 million pounds of beef were recalled. Finally, President Obama himself announced a ban, and said there'd be no backtracking on it.

This was success, at last. But it took eight years of near successes followed by unexpected failures, and it came with important lessons.

First, close the deal. Don't declare "mission accomplished" too early. The slap-down from the conference committee taught me that you have to know who wields the power.

Close the deal. Don't declare "mission accomplished" too early.

Second, don't assume. Just because a directive has been issued doesn't mean it will be dutifully followed. Trust, but verify. On controversial issues, when so much is at stake, vigilance is required.

Third, court adversaries *and* allies, and use self-interest as a motivator. I've learned to reach out to farm industry lobbyists and representatives of rural districts. I frame the arguments in terms that resonate with them. When you win by overpowering your opponents, they may try to find ways to subvert your goal. Lasting victory comes when you find common ground.

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Building Resilience

Martin E.P. Seligman is the Zellerbach Family Professor of Psychology and director of the Positive Psychology Center at the University of Pennsylvania. His latest book is *Flourish: A Visionary New Understanding of Happiness and Well-being* (Free Press, 2011), from which this article is adapted.

What business can learn from a pioneering army program for fostering post-traumatic growth *by Martin E.P. Seligman*

DOUGLAS AND WALTER, two University of Pennsylvania MBA graduates, were laid off by their Wall Street companies 18 months ago. Both went into a tailspin: They were sad, listless, indecisive, and anxious about the future. For Douglas, the mood was transient. After two weeks he told himself, "It's not you; it's the economy going through a bad patch. I'm good at what I do, and there will be a market for my skills." He updated his résumé and sent it to a dozen New York firms, all of which rejected him. He then tried six companies in his Ohio hometown and eventually landed a position. Walter, by contrast, spiraled into hopelessness: "I got fired because I can't perform under pressure," he thought. "I'm not cut out for finance. The economy will take years to recover." Even as the market improved, he didn't look for another job; he ended up moving back in with his parents.

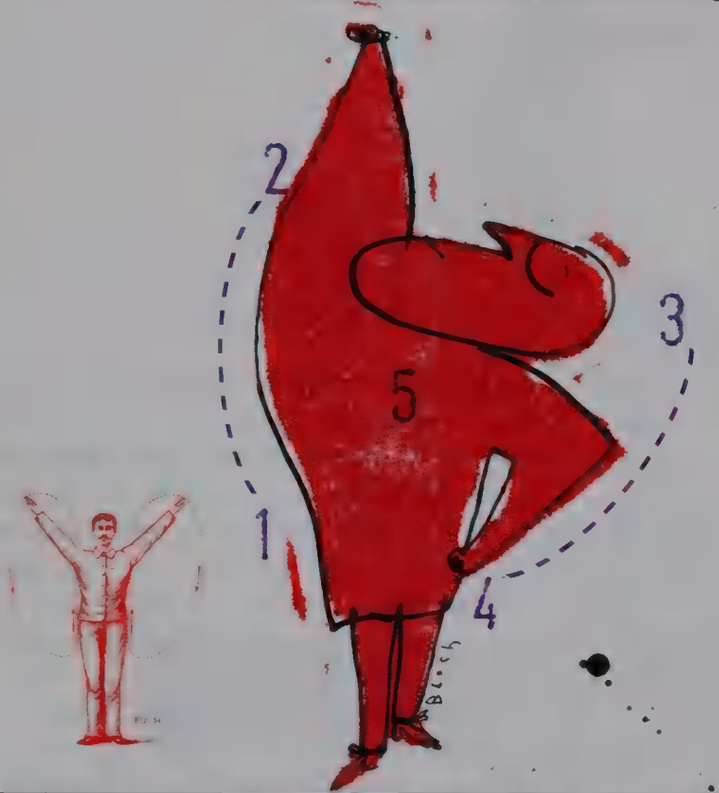
Douglas and Walter (actually composites based on interviewees) stand at opposite ends of the continuum of reactions to failure. The Douglases of the world bounce back after a brief period of malaise; within a year they've grown because of the experience. The Walters go from sadness to depression to a paralyzing fear of the future. Yet failure is a nearly inevitable part of work; and along with dashed romance, it is one of life's most common traumas. People like Walter are almost certain to find their careers stymied, and companies full of such employees are doomed in hard times. It is people like Douglas who rise to the top, and whom organizations must recruit and retain in order to succeed. But how can you tell who is a Walter and who is a Douglas? And can Walters become Douglases? Can resilience be measured and taught?

Thirty years of scientific research has put the answers to these questions within our reach. We have learned not only how to distinguish those who will grow after failure from those who will collapse, but also how to build the skills of people in the latter category. I have worked with colleagues from around the world to develop a program for teaching resilience. It is now being tested in an organization of 1.1 million people where trauma is more common and more severe than in any corporate setting: the U.S. Army. Its members may struggle with depression and post-traumatic stress disorder (PTSD), but thousands of them also experience post-traumatic growth. Our goal is to employ resilience training to reduce the number of those who struggle and increase the number of those who grow. We believe that businesspeople can draw lessons from this approach, particularly in times of failure and stagnation. Working with both individual soldiers (employees) and drill sergeants (managers), we are helping to create an army of Douglases who can turn their most difficult experiences into catalysts for improved performance.

Optimism Is the Key

Although I'm now called the father of positive psychology, I came to it the long, hard way, through many years of research on failure and helplessness.

In the late 1960s I was part of the team that discovered "learned helplessness." We found that dogs, rats, mice, and even cockroaches that experienced mildly painful shock over which they had no control would eventually just accept it, with no attempt to escape. It was next shown that human beings do the same thing. In an experiment published in 1975 by Donald Hiroto and me and replicated many times since, subjects are randomly divided into three groups. Those in the first are exposed to an annoying loud noise that they can stop by pushing a button in front of them. Those in the second hear the same noise but can't turn it off, though they try hard. Those in the third, the control group, hear nothing at all. Later, typically the following day, the subjects are faced with a brand-new situation that again involves noise. To turn the noise off, all they have to do is move their hands about 12 inches. The people in the first and third groups figure this out and readily learn to avoid the noise. But those in the second group typically do nothing. In phase one they failed, realized they had no control, and became passive. In phase two, expecting more failure, they don't even try to escape. They have learned helplessness.



Strangely, however, about a third of the animals and people who experience inescapable shocks or noise never become helpless. What is it about them that makes this so? Over 15 years of study, my colleagues and I discovered that the answer is optimism. We developed questionnaires and analyzed the content of verbatim speech and writing to assess "explanatory style" as optimistic or pessimistic. We discovered that people who don't give up have a habit of interpreting setbacks as temporary, local, and changeable. ("It's going away quickly; it's just this one situation, and I can do something about it.") That suggested how we might immunize people against learned helplessness, against depression and anxiety, and against giving up after failure: by teaching them to think like optimists. We created the Penn Resiliency Program, under the direction of Karen Reivich and Jane Gillham, of the University of Pennsylvania, for young adults and children. The program has been replicated in 21 diverse school settings—ranging from suburbs to inner cities, from Philadelphia to Beijing. We also created a 10-day

What Are Your Strengths?

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The Values in Action signature strengths survey measures 24 positive character traits, among them curiosity, creativity, bravery, persistence, integrity, fairness, leadership, and self-regulation. Participants rank statements on a scale from "very much like me" to "very much unlike me" to determine the areas in which they shine. Here is a sampling:

I find the world a very interesting place.

I always identify the reasons for my actions.

I never quit a task before it is done.

Being able to come up with new and different ideas is one of my strong points.

I have taken frequent stands in the face of strong opposition.

I am always willing to take risks to establish a relationship.

I always admit when I am wrong.

In a group, I try to make sure everyone feels included.

I always look on the bright side.

I want to fully participate in life, not just view it from the sidelines.

Idea in Brief

Failure is one of life's most common traumas, yet people's responses to it vary widely. Some bounce back after a brief period of malaise; others descend into depression and a paralyzing fear of the future.

Thirty years of research suggests that resilience can be measured and taught—and the U.S. Army is putting that idea to the test with a program called Comprehensive Soldier Fitness. The aim of CSF is to make soldiers as fit psychologically as they are physically.

A key component of CSF is "master resilience training" for drill sergeants—a form of management training that teaches leaders how to embrace resilience and then pass it on, by building mental toughness, signature strengths, and strong relationships.

FOCUS ON FAILURE



"It is impossible to live without failing at something, unless you live so cautiously that you might as well not have lived at all."

J.K. ROWLING
AUTHOR

program in which teachers learn techniques for becoming more optimistic in their own lives and how to teach those techniques to their students. We've found that it reduces depression and anxiety in the children under their care. (Another way we teach positive psychology is through the master of applied positive psychology, or MAPP, degree program, now in its sixth year at Penn.)

In November 2008, when the legendary General George W. Casey, Jr., the army chief of staff and former commander of the multinational force in Iraq, asked me what positive psychology had to say about soldiers' problems, I offered a simple answer: How human beings react to extreme adversity is normally distributed. On one end are the people who fall apart into PTSD, depression, and even suicide. In the middle are most people, who at first react with symptoms of depression and anxiety but within a month or so are, by physical and psychological measures, back where they were before the trauma. That is resilience. On the other end are people who show posttraumatic growth. They, too, first experience depression and anxiety, often exhibiting full-blown PTSD, but within a year they are better off than they were before the trauma. These are the people of whom Friedrich Nietzsche said, "That which does not kill us makes us stronger."

I told General Casey that the army could shift its distribution toward the growth end by teaching psychological skills to stop the downward spiral that often follows failure. He ordered the organization to measure resilience and teach positive psychology to create a force as fit psychologically as it is physically. This $145 million initiative, under the direction of Brigadier General Rhonda Cornum, is called Comprehensive Soldier Fitness (CSF) and consists of three components: a test for psychological fitness, self-improvement courses available following the test, and "master resilience training" (MRT) for drill sergeants. These are based on PERMA: positive emotion, engagement, relationships, meaning, and accomplishment—the building blocks of resilience and growth.

Testing for Psychological Fitness

A team led by the University of Michigan professor Christopher Peterson, author of the Values in Action signature strengths survey, created the test, called the Global Assessment Tool (GAT). It is a 20-minute questionnaire that focuses on strengths rather than weaknesses and is designed to measure four things: emotional, family, social, and spiritual fitness. All four have been credited with reducing depression and anxiety. According to research, they are the keys to PERMA.

Although individual scores are confidential, the GAT results allow test takers to choose appropriate

basic or advanced courses for building resilience. The GAT also provides a common vocabulary for describing soldiers' assets. The data generated will allow the army to gauge the psychosocial fitness both of particular units and of the entire organization, highlighting positives and negatives. At this writing, more than 900,000 soldiers have taken the test. The army will compare psychological profiles with performance and medical results over time; the resulting database will enable us to answer questions like these: What specific strengths protect against PTSD, depression, anxiety, and suicide? Does a strong sense of meaning result in better performance? Are people who score high in positive emotion promoted more quickly? Can optimism spread from a leader to his troops?

Online Courses

The second component of CSF is optional online courses in each of the four fitnesses and one mandatory course on post-traumatic growth. The implications for corporate managers are more obvious for some modules than for others, but I'll briefly explain them all.

The emotional fitness module, created by Barbara Fredrickson, a professor of emotions and psychophysiology at the University of North Carolina, and her colleague Sara Algoe, teaches soldiers how to amplify positive emotions and how to recognize when negative ones, such as sadness and anger, are out of proportion to the reality of the threat they face.

Family fitness, too, affects work performance, and cell phones, e-mail, Facebook, and Skype allow even soldiers on combat duty, or expats on assignment, to remain intimately involved with their families. A course created by John and Julie Gottman, eminent psychologists specializing in marriage, focuses on building a variety of relationship skills—including fostering trust, constructively managing conflict, creating shared meaning, and recovering from betrayal.

The social fitness module, developed by John Cacioppo, a professor of psychology at the University of Chicago and an expert on loneliness, teaches empathy to soldiers by explaining mirror neurons in the brain. When you see another person in pain, your brain activity is similar but not identical to what it is when you yourself are in pain. The module then asks soldiers to practice identifying emotions in others, with an emphasis on racial and cultural diversity. This is at the heart of developing emotional intelligence—and diversity in the U.S. Army is a way of life, not just a political slogan.

The spiritual fitness module, created by Kenneth Pargament, a professor of psychology at Bowling Green State University, and Colonel Patrick Sweeney, a professor of behavioral sciences and leadership at West Point, takes soldiers through the process of building a "spiritual core" with self-awareness, a sense of agency, self-regulation, self-motivation, and social awareness. "Spiritual" in CSF refers not to religion but to belonging to and serving something larger than the self.

The mandatory module, on post-traumatic growth, is highly relevant for business executives facing failure. Created by Richard Tedeschi, a professor of psychology at the University of North Carolina at Charlotte, and the Harvard psychologist Richard McNally, it begins with the ancient wisdom that personal transformation comes from a renewed appreciation of being alive, enhanced personal strength, acting on new possibilities, improved relationships, or spiritual deepening. The module interactively teaches soldiers about five elements known to contribute to post-traumatic growth:

1. Understanding the response to trauma (read "failure"), which includes shattered beliefs about the self, others, and the future. This is a normal response, not a symptom of PTSD or a character defect.

2. Reducing anxiety through techniques for controlling intrusive thoughts and images.

3. Engaging in constructive self-disclosure. Bottling up trauma can lead to a worsening of physical and psychological symptoms, so soldiers are encouraged to tell their stories.

4. Creating a narrative in which the trauma is seen as a fork in the road that enhances the appreciation of paradox—loss and gain, grief and gratitude, vulnerability and strength. A manager might compare this to what the leadership studies pioneer Warren Bennis called "crucibles of leadership." The narrative specifies what personal strengths were called upon, how some relationships improved, how spiritual life strengthened, how life itself was better appreciated, or what new doors opened.



The response to trauma includes shattered beliefs about the self, others, and the future.

FOCUS ON FAILURE

THE 13-MONTH CALENDAR

Around the time of the Crash of 1929, HBR got behind a movement to shift to a 13-month calendar. The variation in number of days, the theory went, **caused business reporting discrepancies**. Objections that a new calendar would change most of our **birthdays**, holidays, and anniversaries was **dismissed** in a feature story as **sentimental**.

5. Articulating life principles. These encompass new ways to be altruistic, crafting a new identity, and taking seriously the idea of the Greek hero who returns from Hades to tell the world an important truth about how to live.

Master Resilience Training

The third and most important component of Comprehensive Soldier Fitness is the master resilience training for drill sergeants and other leaders, given at the University of Pennsylvania; at Victory University, in Memphis, Tennessee; at Fort Jackson, South Carolina; and by mobile teams working with troops in Germany and Korea. MRT can be seen as management training—teaching leaders how to embrace resilience and then pass on the knowledge. The content of MRT divides into three parts—building mental toughness, building signature strengths, and building strong relationships. All three are patterned after the Penn Resiliency Program and use plenary lectures, breakout sessions that include role playing, work sheets, and small-group discussion.

Building mental toughness. This segment of MRT is similar in theme to the online emotional fitness course for individual soldiers. It starts with Albert Ellis's ABCD model: C (emotional consequences) stem not directly from A (adversity) but from B (one's beliefs about adversity). The sergeants work through a series of A's (falling out of a three-mile run, for example) and learn to separate B's—heat-of-the-moment thoughts about the situation ("I'm a failure")—from C's, the emotions generated by those thoughts (such as feeling down for the rest of the day and thus performing poorly in the next training exercise). They then learn D—how to quickly and effectively dispel unrealistic beliefs about adversity.

Next we focus on thinking traps, such as overgeneralizing or judging a person's worth or ability on the basis of a single action. We illustrate this as follows: "A soldier in your unit struggles to keep up during physical training and is dragging the rest of the day. His uniform looks sloppy, and he makes a couple of mistakes during artillery practice. It might be natural to think that he lacks the stuff of a soldier. But what effect does that have on both the thinker and the other soldier?" We also discuss "icebergs"—deeply held beliefs such as "Asking for help is a sign of weakness"—and teach a technique for identifying and eliminating those that cause out-of-kilter emotional reactions: Does the iceberg remain meaningful? Is it accurate in the given situation? Is it overly rigid? Is it useful?

Finally, we deal with how to minimize catastrophic thinking by considering worst-case, best-case, and most likely outcomes. For example, a sergeant receives a negative performance evaluation from his commanding officer. He thinks, "I won't be recommended for promotion, and I don't have what it takes to stay in the army." That's the worst case. Now let's put it in perspective. What's the best case? "The negative report was a mistake." And what's the most likely case? "I will receive a corrective action plan from my counselor, and I will follow it. I'll be frustrated, and my squad leader will be disappointed."

Building signature strengths. The second part of the training begins with a test similar to the GAT—Peterson's Values in Action signature strengths survey, which is taken online and produces a ranked list of the test taker's top 24 character strengths. (See the sidebar "What Are Your Strengths?") Small groups discuss these questions: What did you learn about yourself from the survey? Which strengths have you developed through your military service? How do your strengths contribute to your completing a mission and reaching your goals? What are the shadow sides of your strengths, and how can you minimize them? Then the sergeants are put on teams and told to tackle a mission using the team members' character-strength profiles. Finally, the sergeants write their own "strengths in challenges" stories. One sergeant described how he used his strengths

Four Ways To Respond

In master resilience training we explain and demonstrate the four styles of responding: *active constructive* (authentic, enthusiastic support), *passive constructive* (laconic support), *passive destructive* (ignoring the event), and *active destructive* (pointing out negative aspects of the event).

Here's an example: Private Johnson tells Private Gonzales, "Hey, I just got a promotion."

Active constructive
"That's great. What are your new duties? When do you start? What did the captain say about why you deserved it?"

Passive constructive
"That's nice."

Passive destructive
"I got a funny e-mail from my son. Listen to this..."

Active destructive
"You know there's no extra pay, and it will eat up a lot of your R&R time."

Enhancing mental toughness, highlighting and honing strengths, and fostering strong relationships are core competencies for any successful manager.

of love, wisdom, and gratitude to help a soldier who was acting out and stirring up conflict. The sergeant discovered that the soldier felt consumed by anger at his wife, and the anger spilled over to his unit. The sergeant used his wisdom to help the soldier understand the wife's perspective and worked with him to write a letter in which the soldier described the gratitude he felt because his wife had handled so much on her own during his three deployments.

Building strong relationships. The third part of MRT focuses on practical tools for positive communication. We draw on the work of Shelly Gable, a psychology professor at UC Santa Barbara, which shows that when an individual responds actively and constructively (as opposed to passively and destructively) to someone who is sharing a positive experience, love and friendship increase. (See the sidebar "Four Ways to Respond.") The sergeants complete a work sheet about how they typically respond and identify factors that may get in the way of active and constructive responses (such as being tired or overly focused on themselves). Next we teach the work of the Stanford psychology professor Carol Dweck on effective praise. When, for example, a sergeant mentions specifics (as opposed to saying something general like "Good job!"), his soldiers know that their leader was paying attention and that the praise is authentic. We also teach assertive communication, distinguishing it from passive or aggressive communication. What is the language, voice tone, body language, and pace of each of the three styles, and what messages do they convey?

Enhancing mental toughness, highlighting and honing strengths, and fostering strong relationships are core competencies for any successful manager. Leadership development programs often touch on these skills, but the MRT program brings them together in systematic form to ensure that even in the face of terrible failures—those that cost lives—army sergeants know how to help the men and women under their command flourish rather than flounder. Managers can change the culture of their organizations to focus on the positive instead of the negative and, in doing so, turn pessimistic, helpless Walters into optimistic, can-do Douglases. Frankly, we were nervous that these hard-boiled soldiers would find resilience training "girly" or "touchy-feely" or "psychobabble." They did not; in fact, they gave the course an average rating of 4.9 out of 5.0. A large number of them say it's the best course they've ever had in the army.

We believe that MRT will build a better army. Our hypothesis is being tested in a large-scale study under the command of Lieutenant Colonel Sharon McBride and Captain Paul Lester. As the program rolls out, they are comparing the performance of soldiers who have been taught resilience by their sergeants with that of soldiers who haven't. When they are finished, we will know conclusively whether resilience training and positive psychology can make adults in a large organization more effective, as they have done for younger people in schools.

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"I'm meeting with the board. Get me the quarterly profit figures and my blankie."

Failure Chronicles

Peter Guber is the chairman and CEO of Mandalay Entertainment and a co-owner of the Golden State Warriors basketball team. He has produced or executive produced such films as *Rain Man*, *Batman*, *The Color Purple*, and *Flashdance*.

by Peter Guber, Mandalay Entertainment

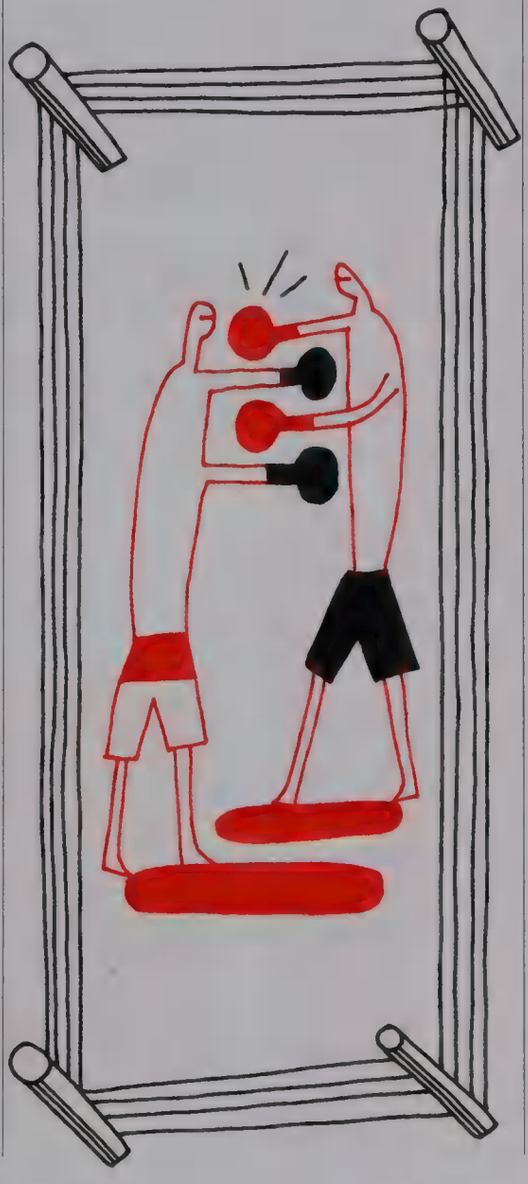
Muhammad Ali taught me: Be active in your own rescue.

Failure has been my handmaiden on the road to success. I make movies and I own sports teams; those are two things you can't do without a significant amount of failure. And public failure at that. Not every movie you make will succeed; every sports team eventually loses. If you're not willing to confront failure, you'll become risk-averse. And if you're risk-averse, you're doomed to fail and get stuck there. I was fortunate to learn this early in my career.

In the 1970s, as studio chief of Columbia Pictures, I began developing a film with Muhammad Ali, called *The Greatest*. I worked tirelessly with Ali and his production team to make it a success, but it failed to be the kind of box office hit that befitted one of the greatest athletes of all time. It was a high-profile failure—and I felt terrible. Everyone told me never to do another sports movie. I wanted to run and hide.

Sometime later, I acquired David Remnick's book *King of the World,* another Ali story. I was worried that after the previous flop, he would refuse to support this new film. But when I approached him, Ali told me a story. He talked about a fight he was in where he was knocked down—"flat on my butt," he said. "And I thought, OK. What's next?"

He got up and won the fight. When you don't get up, he realized, there's no way you can win. In fact, getting knocked down is part of being in the business. It's inevitable. But once you know you can get up, no matter what, you become stronger and resilient.



Getting knocked down is part of being in this business.

Muhammad Ali taught me two things with that story: First, being afraid of failure—of getting knocked down—doesn't get you anywhere. Running and hiding is not the answer. You have to be active in your own rescue.

The second thing was the power of a purposeful story. The story you tell yourself when you think you're down for the count—the story that gets you back on your feet—that's what counts the most.

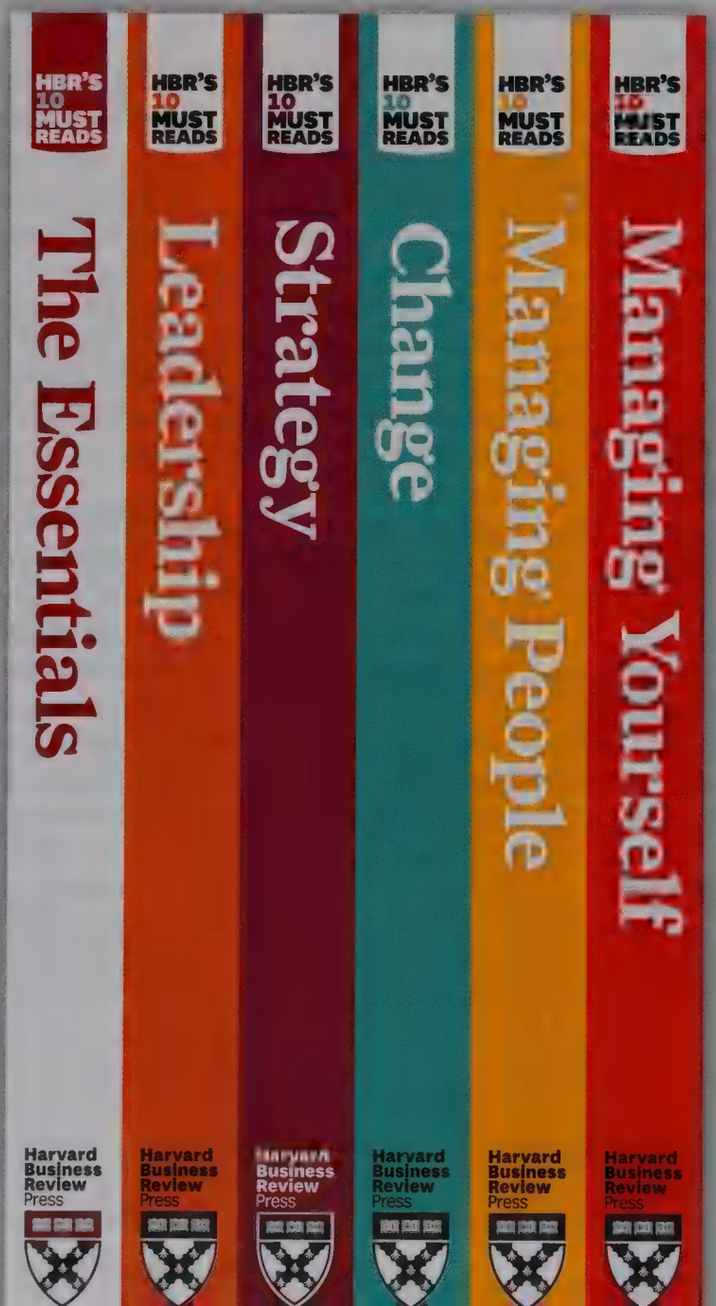
Since then, I've had great successes, but I've also been knocked down plenty. I've had hockey teams that couldn't score, and I've invested in ventures that failed, costing me dearly. When our *Bonfire of the Vanities* was shown on airplanes, people still tried to walk out. But I never have the urge to run and hide. I remember what Ali told me, and I use the power of that story to help myself stay active in my own rescue.

Failure is an inevitable cul-de-sac on the road to success. Keep taking risks—and always get back up. Or you'll never see how great your success can be.

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Failure **Recover from It**

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The Globe

How China Reset Its Global Acquisition Agenda

The first cross-border takeovers by Chinese companies ended in failure. That hasn't prevented them from trying again—with a whole new approach. *by Peter J. Williamson and Anand P. Raman*

China Inc. sometimes seems unstoppable. The perception is understandable; no other nation has come close to matching the economic strides China has made since the late 1970s. The changes in the country have been so rapid and dazzling, however, that they often blind observers to the fact China has had its share of failure, too.

The cross-border mergers-and-acquisitions spree that Chinese companies went on in the past decade bears ample testimony to that. In 2000, shortly before China acceded to the World Trade Organization, its government realized that local companies would need to be globally competitive to survive and announced a *zou chuqu* (which loosely translates as "swarm out") policy that permitted local companies to make acquisitions abroad for the first time. Numerous state-owned enterprises, as well as private corporations, jumped at the opportunity. The value of Chinese M&A shot from $1.6 billion in 2003 to $18.2 billion by 2006, triggering worldwide unease about the China takeover threat.

Yet it's worth looking back at that first wave of takeovers. Many of those mergers—which included TCL's acquisition of France's Thomson Electronics, SAIC's takeover of South Korea's Ssangyong Motor Company, Ping An's investment in the Belgian-Dutch financial services group Fortis, Ningbo Bird's strategic partnership with France's

Sagem, and the D'Long Group's purchase of America's Murray Inc.—ended in utter failure, with Chinese companies having to pull out of or sell off their acquisitions.

Unlike other developing nations, however, China wasn't paralyzed by failure, and it has quickly—and quietly—changed course to take another shot at its goals. The Chinese, especially the older generation, believe that failure is not about falling down but about refusing to get up. "If you get up one more time than you fall, you will make it through," runs an old Chinese saying. In short order, China's policy makers and executives have refashioned their M&A approach and altered both the kinds of targets they pursue and their rationale for global takeovers.

Instead of buying global brands, sales networks, or goodwill, Chinese companies now mainly try to acquire concrete assets, such as mineral deposits, or state-of-the-art technologies and R&D facilities. In addition, Chinese companies no longer use their overseas takeovers to gain market share abroad; they deploy them to strengthen their positions in the Chinese market.

It's too soon to say whether the new approach is working, but the initial results, which we will describe in the following pages, are encouraging. Wisdom comes from good judgment; good judgment comes from experience, and—say the Chinese—experience comes from all the times you use bad judgment. By failing spectacularly and early, China's takeover artists could well have discovered how to succeed in the future.

A Race off a Cliff

China's global M&A strategy has evolved rapidly over the past decade. In the 1990s, when the government swapped access to China's markets for technologies from abroad, it mostly allowed state-owned enterprises (SOEs) to buy small equity stakes in overseas energy companies and natural resource producers. Beijing preferred that other companies use a *yinjin lai* (or "pull in") strategy, entering into joint ventures, partnerships, and technology-licensing deals with foreign companies. That approach changed in October 2000, 15 months before China signed the WTO agreement, partly because the government became convinced that Chinese companies would forever play second fiddle if they depended on technology transfers from multinational companies.

Over the next three years, Beijing dismantled several hurdles to cross-border investments that it had erected in the 1990s. In late 2004, Premier Wen Jiabao formally announced, "The Chinese government encourages more enterprises to go global," and the race to buy companies overseas began in earnest. The number of foreign acquisitions made by Chinese companies rose rapidly: They doubled from 40 in 2003 to 82 in 2006 and reached a peak of 298 in 2008.

In the five years that SAIC controlled Ssangyong, it invested $618 million in the Korean auto company—and earned virtually nothing.

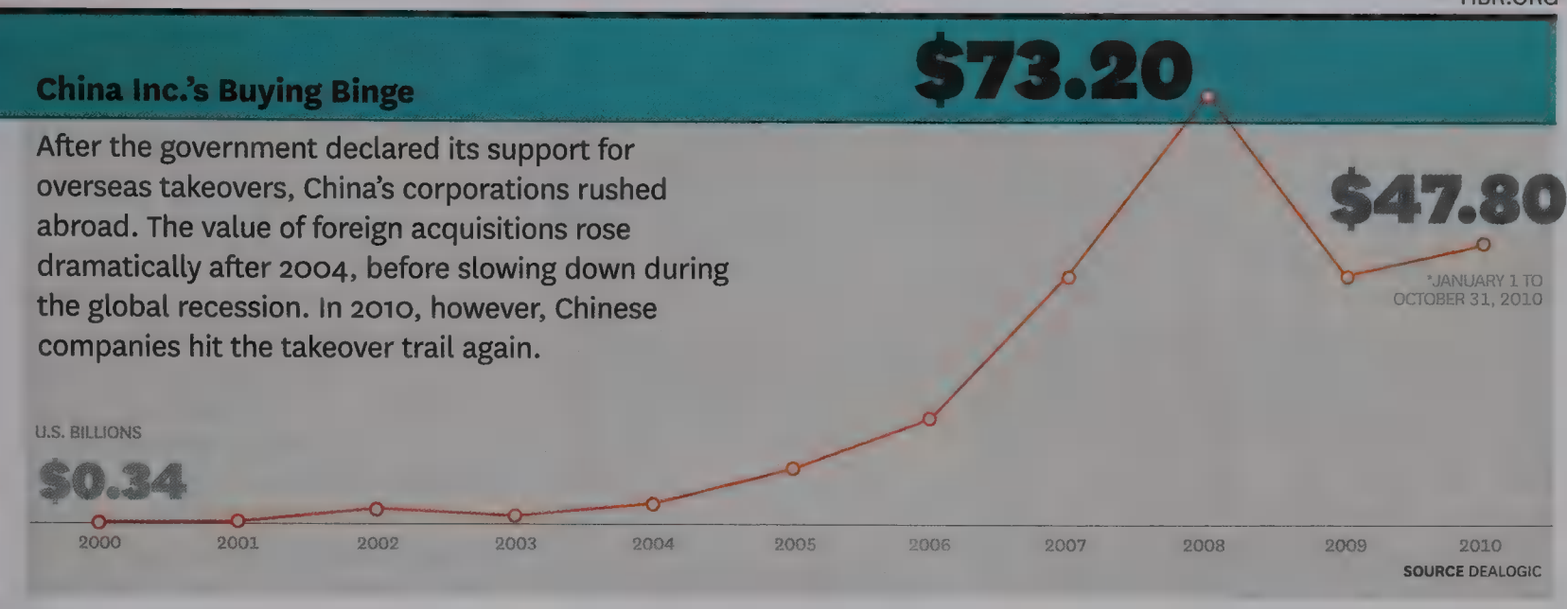
However, many takeovers, especially those executed by China's private sector groups, ended quickly and badly. Some acquirers had to sell off their investments, some scaled back their ambitions radically, and some even went broke. To understand why things went wrong, we studied three big headline-grabbing acquisitions of the time—one by an SOE, one by a private company, and one by a joint venture. Together they provide a comprehensive picture of Chinese acquirers' mistakes.

The SAIC–Ssangyong Motor Company saga. Shanghai Automotive Industry Corporation's short-lived attempt to run the South Korean automaker Ssangyong demonstrated that Chinese companies weren't ready to deal with changes in the global marketplace.

One of China's biggest and oldest automobile manufacturers, SAIC picked up a 49% equity stake in Ssangyong for $500 million in October 2004, beating out many bidders, including General Motors. Ssangyong was then struggling under the weight of its debt burden, but it had launched some smart sports utility and recreational vehicles. As South Korea's fourth-largest automaker, it had a 10% share of its home market as well as a growing export business. Buying Ssangyong, SAIC thought, would allow it to improve its automobile development capabilities and make headway in markets such as the United States.

After the deal an SAIC-Ssangyong joint management team drew up plans to swiftly expand manufacturing capacity in South Korea and launch five new models worldwide. However, things did not go as planned. Rising gasoline prices in 2006 and stringent new emissions standards in Europe and North America sent SUV sales tumbling. During this crisis, SAIC's relations with Ssangyong's powerful trade unions grew strained, culminating in a seven-week strike, and because of cultural reasons, Chinese and Korean executives couldn't agree on how to improve performance. Once the global recession started in December 2007, automobile demand collapsed. Sales of SUVs were particularly hard hit, and Ssangyong's sales fell by 53% in December 2008 compared with the previous December.

SAIC initially supported its subsidiary, buying $4.5 million worth of Ssangyong's vehicles in late 2008 to sell in the Chinese market. When the situation worsened, however, SAIC unveiled a restructuring plan that included an overhaul of work practices to improve productivity and a 36% reduction in the workforce. Those were its conditions for pumping $200 million more into the Ko-



rean company. Ssangyong's unions refused to endorse the plan, protested, and initiated legal action against SAIC for allegedly transferring to China SUV designs and technologies developed with South Korean government funding—a charge SAIC denies.

Left with no alternative, Ssangyong filed for bankruptcy protection in January 2009. That spring, angry workers went on strike again, barricading themselves inside the automaker's plant near Seoul for 77 days. Even as Ssangyong struggled, SAIC wrote off most of its original investment, blamed the losses for a 26% drop in its first-half profits for 2009, and in mid-July 2010 diluted its holdings to just 3.79%. In the five years that SAIC controlled Ssangyong, it invested $618 million in the company—and earned virtually nothing.

The D'Long Group–Murray disaster. The first overseas takeovers by China's private sector companies also went badly. One of the first to push into North America was the $4 billion D'Long Group, a new-style conglomerate with businesses ranging from tomato paste to automobile parts. In 2000 it entered the lawn mower and garden equipment business by acquiring Murray Inc., in a deal backed by GE Capital, which provided $400 million in financing.

Murray, based in Brentwood, Tennessee, was then one of the leading brands of outdoor power equipment in the West. Its profits had been falling steadily because of price-based competition from overseas (read: China). After the acquisition, D'Long integrated its Chinese manufacturing facilities with Murray's, identified lower-cost sources of components, and restructured the organization to reduce overhead.

Soon after the integration began, the American company suffered from a series of quality issues and product recalls. In 2004, for instance, it had to recall nearly 100,000 lawn tractors because their fuel tanks were prone to developing large cracks. These problems dented the brand, made it difficult for Murray to raise money, and caused sales to slide.

Meanwhile, after the Chinese government hiked interest rates and reduced money supply to cool down the overheated economy, D'Long found itself running out of resources. With its options becoming limited, the group raised capital by pledging the shares of its listed companies as collateral for loans, making rights issues, and providing guarantees for loans. To keep the cycle going, it illegally started using funds from its trusts and finance companies to prop up its share prices.

In 2004 the house of D'Long collapsed, after the China Banking Regulatory Commission named it among the country's highest-risk companies and banks refused to extend it any more loans. Murray Inc. filed for bankruptcy in November 2004. Its operations were shut down, and Britain's Briggs & Stratton bought its brands.

The TCL-Thomson debacle. If one deal epitomized the inability of Chinese companies to assimilate foreign corporations, it would be TCL's acquisition of France's Thomson. China's largest maker of color televisions and second-largest maker of mobile telephones, TCL started promoting its brand internationally in 2000. Emboldened by its early successes, in January 2004 it struck a $560 million deal to merge its TV and DVD operations with those of consumer electronics giant Thomson. The new company, TCL-Thomson Electronics (TTE), in which TCL held a 67% equity stake, went into operation that July.

By 2006, it was clear that TCL had bitten off more than it could chew. TCL hadn't examined Thomson's balance sheet carefully before investing in the venture. It had refused to hire M&A experts to perform due diligence, and when a Boston Consulting Group analysis suggested that too much risk was involved, TCL's chairperson, Li Dongsheng, ignored the "pessimistic" report.

TCL just hadn't realized that the Thomson brand in Europe and Thomson's RCA brand in America were both old and tired. In fact, the French manufacturer's TV and DVD operations had lost more than $100 million in 2003, which is why the company had been looking for an investor. The deal was a complex one, which didn't help. For instance, TCL had to negotiate separate contracts to access those parts of the business that weren't transferred to TTE, such as the sales division and critical intellectual property.

Above all, TCL lacked the capabilities to assimilate Thomson's people. The shortage of Chinese managers with international experience and expertise in global marketing proved to be a major constraint. The new company was dysfunctional because people came from different cultures and had different routines. When TCL imposed its practices on the venture, culture clashes erupted. For example, Chinese executives were shocked to find that if they tried to schedule meetings on weekends—a regular occurrence in China—their French counterparts would turn off their phones and be

unavailable. TCL also had been expanding so rapidly that it didn't have the bandwidth to cope with Thomson.

Because of its troubles in Europe, TCL suffered a combined loss of RMB 5.07 billion ($680 million) in 2005 and 2006. In May 2007, TCL declared the European operations insolvent and overhauled them by doing away with Thomson's business model and distribution channels—and even the brand. It closed five of its seven European centers and terminated a large number of employees. The grand alliance between TCL and Thomson had taken just three years to unravel.

As these cases and others show, the first wave of Chinese acquirers bought foreign companies mainly to grow their global sales. Their logic seemed impeccable: Take low-cost Chinese manufacturing capacity and connect it to the global brands and distribution relationships of a Western company hampered by high costs. What sounded like a dream marriage of Chinese manufacturing with American or European marketing proved to be a nightmare, however, because of the errors committed by the acquirers. (See the box "China's M&A Mistakes.")

Beijing Gets Cold Feet

By 2007 the Chinese government was concerned about the problems its companies were facing overseas. The last straw was probably the troubles that Lenovo—the poster child for Chinese M&A after its acquisition of IBM's PC division for $1.75 billion in December 2004—ran into with its global push. Although the merger made the Chinese company the world's third-largest PC maker, after HP and Dell, a year later it slipped to fourth place behind Taiwan's Acer. As Lenovo struggled with integration issues, the exodus of technical employees, and substandard service, its market share and profitability slid further. For instance, its net profits from July through September 2008 fell to $23.4 million—a 78% decline year-on-year.

Word then went out from Beijing that only SOEs and private companies with adequate managerial capabilities and merger integration skills should attempt takeovers. The government also signaled that as far as possible, Chinese companies should pursue profitable targets. A line had been drawn—and no one would be allowed to cross it. When the unknown Sichuan Tengzhong Heavy Industrial Machinery wanted to acquire General Motors' Hummer division in June 2009, the National Development and Reform Commission refused to endorse the bid, even though China's Ministry of Commerce didn't think it was a bad idea. The deal fell through—one of the first takeover attempts that the Chinese government publicly shot down.

However, with China's foreign exchange reserves crossing $2 trillion in 2009, diversification beyond U.S. Treasury bonds into physical assets that didn't run the risk of having their value decimated by inflation looked more appealing. The stock market crash also made overseas company valuations attractive. The government and its agencies, like the State-Owned Assets Supervision and Administration Commission, keen to ensure that Chinese companies became globally competitive before they allowed the renminbi to appreciate, began to rethink their policies on M&A.

China's M&A Mistakes

Pursuing inexpensive deals and unprofitable businesses. Such targets usually require large investments of time and money to turn around.

Focusing on the financials and ignoring intangibles such as systems, people, processes, and brand values while evaluating targets.

Skipping key steps in the M&A process.

Picking up companies whose value consisted mostly of brands, systems, people, and culture, which are difficult to integrate across borders.

Failing to figure out in advance how to use acquisitions' products and services in the Chinese market.

Trying to handle knotty integration issues without the right capabilities or people.

The Revamped Approach

An analysis of half a dozen recent takeovers by Chinese companies suggests that a new three-pronged strategy is helping China Inc. make its global acquisitions perform better.

A shift to hard assets. Instead of purchasing brands and distribution relationships, Chinese companies are increasingly buying tangible assets such as mineral deposits and oil reserves. Performing due diligence on hard assets is relatively straightforward; they can be objectively assessed by engineers and don't require evaluations of variables such as corporate culture or brand essence. Integration is simpler because companies with tangible assets have proven supply chains, and the acquirers can leave their operations more or less alone. Besides, there's a strong demand in China for these companies' output.

By 2009 more than 70% of Chinese deals involved either energy or natural resources. Among them: Yanzhou Coal's $2.8 billion takeover of Australia's Felix Resources, and Sinopec's $7.2 billion acquisition of the Swiss-registered oil and gas company Addax.

A quest for high tech. The Chinese are also targeting organizations that can deliver emerging and new technologies and possess offshore R&D facilities. Their value lies in their intellectual property, knowledge, and research and design processes. Although integrating those assets is a bit more difficult, it's less complicated and risky than assimilating an entire organization.

Patents and blueprints can be beamed to China, where an engineer can easily in-

terpret them. R&D centers have relatively small staffs, although they do need a lot of motivation. Given the acquirers' willingness to invest in R&D and the prospect of adapting and selling their innovations to the Chinese market, most researchers are excited about takeovers by Chinese companies. Interfaces with the Chinese organization are simple: Foreign engineers come up with ideas for new products and processes, and the Chinese use their skills to scale up the inventions and drive down their manufacturing costs.

One company attempting this kind of takeover is Xi'an Aircraft Industry Corporation (XAC), a subsidiary of the state-owned Aviation Industry Corporation of China (AVIC). AVIC's first several attempts to buy aircraft manufacturers met with failure, so it was a surprise to industry experts when, in October 2009, XAC announced that it had reached an agreement to buy 91.25% of Austria's Fischer Advanced Composite Components. FACC is one of the leading suppliers of the composites used in everything from airplane wings to engine nacelles and cabins. However, it had invested heavily in supporting the new generations of the Boeing Dreamliner and Airbus A350 XWB, and when those programs stumbled, FACC found itself struggling with losses and depleted cash reserves.

The Chinese company agreed to invest $60 million in FACC as part of an undisclosed purchase price estimated to be near $135 million. FACC's management thus secured the company's financial future, obtained capital for expansion, and got access to the booming Chinese market through AVIC. In turn, XAC gained leading-edge composite materials technology and a large pool of engineers that its parent, AVIC, could use in China's aircraft programs, including the development of the ARJ21 regional jet and the C919, which will compete with the Airbus A320 and Boeing 737.

Meng Xiangkai, XAC's vice chairman, doesn't wish to change FACC into a Chinese company in Europe. He wants to retain the management culture that underpins FACC's success in high-tech R&D.

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The pursuit of growth at home. In a reversal of strategy, some Chinese companies are no longer using takeovers to gain market share abroad. Instead, their goal is to strengthen their positions at home. This fits in with the Chinese government's desire to boost domestic consumption in the aftermath of the global recession.

After its $1.8 billion acquisition of Volvo in 2010, Geely announced that its first goal would be to integrate Volvo's technology and design know-how into three new manufacturing facilities—in Shanghai, Chengdu, and Daqing—to serve the Chinese market. The plan is to ramp up Volvo's sales in China from 24,000 to 300,000 cars a year—and nearly double Volvo's worldwide sales.

The new strategy has distinct advantages over the old approach. One, the Chinese market is a good environment in which to test and understand an acquired company's assets and capabilities. Two, rather than trying to wrest share from entrenched rivals abroad, the acquirer can reap a deal's benefits quickly in the fast-growing local market. Three, integrating new technologies, products, and know-how is easier at home, where the parent's executives know the terrain well. Finally, since the deal provides the employees of the acquired company an opportunity to apply their skills to the world's most promising market, it helps them see the takeover in a positive light.

Rather than trying to wrest share from entrenched rivals abroad, acquirers are using cross-border deals to reap benefits quickly in the Chinese market.

Another company that has deployed this approach successfully is China National Chemical Corporation (ChemChina), which took over a French manufacturer of animal nutrition additives, Adisseo, in January 2006. The world's second-largest producer of methionine, a key additive used in the poultry industry, Adisseo had a global market share of 29%, but it had failed to make any headway in China's rapidly growing poultry sector and couldn't expand on its own because of a weak balance sheet that bore the scars of the severe acute respiratory syndrome (SARS) outbreak in 2003.

By buying the French company for $480 million, ChemChina obtained methionine production technologies that were then nonexistent in China. As one of the country's largest chemical producers, it already had the distribution channels and ground organization needed to rapidly ramp up sales. ChemChina's chairperson, Ren Jianxin, aptly calls the M&A strategy "going out" and "bringing in." He sold the idea to Adisseo's top management, which recommended the ChemChina bid to shareholders mainly because it would open the door to the Chinese market.

So far, no one has been disappointed. Given the responsibility of growing the methionine business in China, Adisseo's managers and engineers have made ChemChina the country's largest supplier of poultry additives.

In keeping with the partnership approach to M&A that other emerging giants have used, Chinese companies are increasingly leaving incumbent managements in place. (See "Don't Integrate Your Acquisitions, Partner with Them," by Prashant Kale, Harbir Singh, and Anand P. Raman, HBR December 2009.) Some even task the acquired teams with running the Chinese operations as well. After ChemChina acquired Adisseo and Rhodia's silicone unit, it made their CEOs responsible for those businesses both globally and in China.

Once they grow profits in the booming Chinese market, it's easy for acquirers to set off that elusive postmerger cycle of growth. Wanxiang, China's $10 billion automotive components powerhouse, is deploying this two-step plan. After buying more than a dozen companies in the developed world and integrating their technologies and know-how into its Chinese operations, Wanxiang is now aiming to build global market share by investing in several overseas subsidiaries.

KNOWING WHEN to walk away from a deal is usually the hallmark of M&A sophistication. At least some Chinese acquirers are finally doing it. For instance, Bright Food, a leading food company based in Shanghai, wasted more than a year trying to buy Sucrogen before losing out to Singapore's Wilmar last July. In December 2010 it came close to acquiring GNC, the American health products retailer, but just a month later Bright Food dropped out of the negotiations, apparently because the price was too high. Ten years ago, Chinese companies would have insisted on clinching a deal at any price. That they no longer do so is perhaps the brightest sign that China Inc. is learning from its M&A mistakes.

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China's New M&A Approach

Buying physical assets such as oil fields and natural resources rather than intangible ones such as brands.

Looking for companies or organizations that possess state-of-the-art technologies and global R&D facilities.

Using overseas takeovers to strengthen the company's position in the Chinese market rather than in foreign markets.

Failure Chronicles

Whitney Johnson is a founding partner of Clayton M. Christensen's investment firm, Rose Park Advisors.

by Whitney Johnson, Rose Park Advisors

I lost the friendship, along with a painful amount of money.

I love hearing about—and investing in—other people's dreams. Unfortunately, my first foray into funding a fledgling dream became a living nightmare.

Several years ago, a friend came to me with her idea of starting a magazine. I thought she had a strong concept for an underrepresented topic in the women's lifestyle space—so much so that in addition to investing cash, I persuaded my husband to act as chief operating officer for the start-up.

As we negotiated the shareholder structure, I was fair to a fault. An entrepreneur friend had just watched his equity stake go through massive dilution when his venture backers increased the valuation of his company. With his experience fresh in my mind, I resolved not to become like those investors. So, notwithstanding my significantly larger contribution of cash (in both equity and unsecured loans) and my husband's contribution of effort, we agreed to be minority shareholders with limited rights. If the business worked, we had less upside. If it failed, we stood to lose far more. In retrospect, this was naive.

As we moved from idea to execution, I asked another friend to take a key role in the project. She told me repeatedly: You need to better articulate the business plan, especially the decision-making process. But I refused to listen. Pointing to the importance of discovery-driven planning, I told her that we would "figure it out." Because my husband and I were the providers of working capital, I had the luxury of being cavalier.



We got off to a great start: The magazine was written up in the *New York Times,* and after just a few months, circulation reached 100,000. But the success was short-lived. In neglecting to craft a detailed business plan, we had failed not only to chart a path to profitability but also to put in place the processes that would allow us to make tough decisions. Who had the final say on the strategic direction? Cover art? Budget? Print runs? Hiring? We were at loggerheads with our partner quite often, but thanks to the management and deal structure I had freely agreed to, my husband and I had little say in the critical decisions.

Investing in an entrepreneur is a lot like falling in love. Only later do flaws become apparent.

Because we hadn't hammered out exactly how we would operate, infighting distracted us, cash became a concern, and the business imploded. My husband and I lost the friendship, along with a painful amount of money.

Investing in an entrepreneur is a lot like falling in love. At first, we just see the best; only later do flaws and failings become apparent. No one's perfect, of course. But sometimes our partners' weaknesses in combination with our own constitute a deadly cocktail.

It would be disingenuous to say I have no regrets. This failure was dearly bought. It was a severe blow to both my ego and my bottom line. But the lessons I learned about setting boundaries and establishing rules of engagement were invaluable. I now invest more effectively in stocks and start-ups, as well as in people and their dreams.

Failure was worth every cent.

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Experience

MANAGING YOURSELF



Inappropriate responses to failure can derail your career. Figure out what "type" you are and use these strategies to change your bad habits. *by Ben Dattner and Robert Hogan*

In his brilliant 1950 film, *Rashomon*, the Japanese director Akira Kurosawa depicts the story of a rape and murder four times, from the perspectives of four characters. The message is clear: Different people can see the same events in dramatically different ways.

In the workplace this phenomenon is particularly evident when it comes to underperformance and failure. An outcome that an employee regards as satisfactory may be seen by his boss as entirely unacceptable. When a project is an unequivocal flop, colleagues disagree over the reasons why. These reactions, and their effect on workplace relationships, often become more problematic than the original event. As a result, how people respond to negative feedback is of great importance to managers and organizations and is a major determinant of career success.

Consider the case of a pharmaceutical company seeking FDA approval for a new use of an existing drug. (Some details have been changed to protect client confidentiality.) Wendy, a talented researcher, was put in charge of the large-scale data analysis required to file an application. She considered several approaches and recommended the one she thought best balanced the need for accuracy and comprehensiveness with the imperative to complete the work quickly and on budget. Her boss, George—the company's head statistician—agreed with the plan, and together they presented it to the vice president of medical affairs, Don. Although Don would have liked a more thorough approach, he recognized that it would be more expensive, and he signed off on the recommendation.

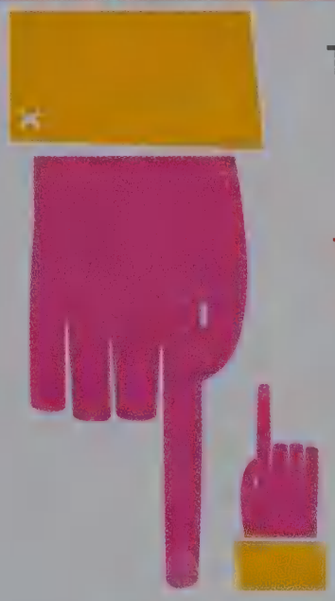
After months of work the analysis failed to demonstrate the efficacy of the drug for the new use, and the application to the FDA had to be scrapped. Reactions varied. Don blamed the statistics department, and especially George, for recommending the approach it had taken. George did not think that he and his team were at fault, and he was angry with Don for allowing financial pressures to influence their choice in the first place. The two men struggled to work together. Wendy, meanwhile, felt she had personally fallen short and began having trouble focusing on her other assignments.

How could three people have such different views of the same situation?

A Matter of Type

Personality psychology provides a research-based behavioral science framework for identifying and analyzing

Recognize Your Type



The 11 personalities below have dysfunctional reactions to blame.

These types represent roughly 70% of the U.S. population.

BLAMESOTHERS

EXTRAPUNITIVE

EXCITABLE: "VOLATILE GUARDIAN"
Overreacts to minor mistakes

Determines failure prematurely

CAUTIOUS: "SENSITIVE RETIRER"
Expects failure to occur

Is too defensive to learn from feedback

SKEPTICAL: "WARY WATCHER"
Believes he will be unfairly blamed

Sees only criticism in constructive advice

LEISURELY: "RATIONALIZING BLAMER"
Looks for and offers up excuses

Often blames whoever assigned the task

BLAMESONESELF

INTROPUNITIVE

DILIGENT: "MICROMANAGER"
Criticizes himself for even minor errors

Is so concerned about failure that he may suffer "analysis paralysis"

DUTIFUL: "MARTYR"
Accepts more blame than she deserves in order to preserve work relationships

Blames herself so harshly that others typically refrain from criticizing her

DENIESBLAME

IMPUNITIVE

BOLD: "BIG [illegible] ON CAMPUS"
Becomes angry or hurt when blamed

Ingratiates herself with her superiors in the hope of avoiding blame

MISCHIEVOUS: "HIGH-WIRE WALKER"
Denies his role in failure; may deny that failure has even occurred

Distorts information to avoid blame

[illegible]: "INDIFFERENT DAYDREAMER"
Ignores potentially helpful feedback

Seems not to care about failure or blame

COLORFUL: "THESPIAN"
Expects forgiveness for any and all failures

Would rather be blamed than ignored

IMAGINATIVE: "ASSERTIVE DAYDREAMER"
Offers complex explanations for failures

Seems anxious about being blamed in the future but indifferent in the present

how people respond to failure and assign blame. Using data on several hundred thousand managers from every industry sector, we have identified 11 personality types likely to have dysfunctional reactions to failure. For example, there is the Skeptical type, who is very smart about people and office politics but overly sensitive to criticism and always on the lookout for betrayal; the Bold type, who thinks in grandiose terms, is frequently in error but never in doubt, and refuses to acknowledge his mistakes, which then snowball; and the Diligent type, who is hardworking and detail oriented, with very high standards for herself and others, but also a micromanaging control freak who infantilizes and alienates subordinates. These types represent roughly 70% of the U.S. population. (See the sidebar "Recognize Your Type.")

The 11 types can be divided into the three broad categories proposed by the psychologist Saul Rosenzweig in the 1930s, which were based on a test that he had developed to assess anger and frustration. Some people are *extrapunitive*—prone to unfairly blaming others. Some are *impunitive:* They either deny that failure has occurred or deny their own role in it. And some are *intropunitive,* often judging themselves too harshly and imagining failures where none exist.

In our pharmaceutical example, Don, an Excitable type, exemplifies extrapunitive tendencies. He takes the statistics team to task instead of accepting any personal responsibility or attributing the failure to the drug itself. Extrapunitive responses are all too common in the business world. Seemingly every time executives testify before Congress—whether it's Tony Hayward, then BP's CEO, disavowing blame for the oil spill, or Richard Fuld, then Lehman Brothers' CEO, disavowing blame for the financial crisis—they point fingers at any organization except their own. Interestingly, long before they found themselves in the hot seat, both Hayward and Fuld were faulted for other instances of mismanaging blame. (HBR tried to



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reach Hayward and Fuld to give them the opportunity to respond but received no reply.)

The chief statistician, George, a Bold type, was impunitive, denying that he and his team had anything to do with the bad outcome. One well-known executive who has been accused of this sort of behavior is Carly Fiorina, a past CEO of Hewlett-Packard. Disgruntled former subordinates have described her as a self-promoting attention seeker who ignored integration challenges and day-to-day operations following HP's 2002 merger with Compaq and took no responsibility when the combined company failed to live up to its potential. When the HP board suggested that she delegate greater authority to her team and more power to the heads of key business units, she refused and was subsequently dismissed. (When HBR contacted Fiorina's chief of staff about this article, she declined to comment.)

Though less common than extrapunitive and impunitive personality types, people with intropunitive tendencies can also be problematic. The researcher Wendy, a Diligent type, exhibited this behavior by taking on excessive blame. This may have been due in part to her gender: Because of their socialization and other cultural influences, women are more likely than men to be intropunitive.

The underlying theme of our research is that many managers perceive and react to failure inappropriately and therefore have trouble learning from it—leading to more failures down the road. Many of us have at some point assigned (or avoided) blame in a self-serving way, only to suffer negative fallout; on the flip side, we may take self-criticism too far, resulting in paralysis and stagnation. To foster and thrive in a productive work environment, we need to recognize and overcome these tendencies.

How to Change Your Stripes

Fortunately, managers at all levels of organizations, and at any stage of their careers, can fix their flawed responses to failure. Here are some key steps you should take:

Cultivate self-awareness. First, it's important to determine whether you fall into one of the three categories. Several personality tests can help you assess your interaction style. Although the Myers-Briggs Type Indicator is probably the best known, others have more empirical support. One well-established model we've found particularly helpful is the Big Five, which measures openness to experience, conscientiousness, extroversion, agreeableness, and neuroticism, along with subfactors of these dimensions. It does a good job of illuminating how you deal with failure in yourself and others. For example, you may find that you score high on the *achievement-striving* subfactor of the conscientiousness dimension, indicating that you may become easily distressed if you don't meet ambitious goals. Or you might score high on the *anger* subfactor of neuroticism, suggesting a tendency to disproportionately fault others for minor errors and to exaggerate their gravity. (To assess yourself on the five dimensions and their subfactors, you can take the IPIP-NEO test, available free at personal.psu.edu/j5j/IPIP/ipipneo120.htm.)

Another useful exercise is to reflect on challenging events or jobs in your career, considering how you handled them and what you could have done better. You might ask trusted colleagues, mentors, or coaches to evaluate your reactions to and explanations for failures. Pay close attention to the subtleties of how people respond to you in common workplace situations, and ask for formal or informal 360-degree feedback; you may be surprised at what you discover.

For example, one media industry CEO we've worked with, an Excitable type, saw no problem with his habit of forcefully and publicly pointing out subordinates' minor errors. During an executive-coaching process he learned that his employees perceived him as extrapunitive. He realized that they had a more hierarchical worldview than he did and that he had underestimated how criticism from him—the boss—might affect them. He also came to accept that small mistakes should be treated differently from big ones, and that feedback on them should be balanced with encouragement.

Self-awareness is also helpful for people in the other two categories. If you find that others often see failure where you don't or if you have a hard time pinpointing times when you've failed, you might be impunitive (or at least risk coming across that way). At the other extreme, if you're constantly anxious about failing or if colleagues often reassure you that things aren't as bad as you think, you may be intropunitive.

Although not everyone has the time, inclination, or resources to get the kind of coaching or counseling necessary to surface and address deep psychological issues with respect to failure and blame, everyone can undertake and benefit from this sort of reflection.

Cultivate political awareness. Even if you've analyzed your behavior and think that you act appropriately with respect to blame, your colleagues might disagree. As the media industry CEO learned, you must know your audience and recognize that each situation is different. Behavior that was appropriate in the past might be perceived as extrapunitive, impunitive, or intropunitive in a new role or company. Whereas self-awareness helps you understand what messages you're sending, political awareness helps you understand what messages others are receiving. It requires that you know how your organization defines, explains, assigns responsibility for, and attempts to remedy failure.

Take the case of a COO who had recently joined a health care nonprofit. As part of a large-scale change effort, he was asked to lead a task force that would identify inefficient processes and make recommendations for improvements. Other members of the executive team were assigned to lead other groups. Because he was very busy with his day-to-

When a failure has occurred, don't respond impulsively. It's not always possible to right the wrong, but it's almost always possible to make things worse.



day work, the COO and his task force fell behind. When the CEO held a meeting to discuss the various groups' progress and share their findings, the COO, a Reserved type, simply described his team's activities, making no mention of their missed deadlines and failure to deliver any results. This made the CEO angry; he perceived the COO's behavior as impunitive and felt that it set a bad example for the other task forces. Fortunately, the CEO was not a blaming type. After the meeting he privately told the COO that although falling behind schedule might have been unavoidable, he had to take responsibility for the delay. The COO realized that the nonprofit's culture was different from the cultures he'd experienced at other companies. In his previous jobs, leaders were expected to hide their shortcomings, not acknowledge them as a means of showing their commitment to improving. The COO had to learn how to criticize himself, appropriately and publicly, in order to succeed in his new job.

Political awareness involves finding the right way to approach failure within your specific organization, department, and role. An intropunitive person might be effective at a small, highly collegial company but have to change his ways at a larger, more competitive one, where rivals might take advantage. An extrapunitive boss who only slightly softened her criticisms when independently running a sales department might have to tone them down further when coleading a cross-divisional team.

Embrace new strategies. Once you're aware of your bad habits, you can move toward more-open, adaptive responses. The strategies needed can work for any of the dysfunctional types. The first is to *listen and communicate.* It sounds obvious, but most of us forget to gather enough feedback or sufficiently explain our actions and intentions. Especially when it comes to credit and blame, never assume that you know what others are thinking or that they understand where you are coming from.

The second is to *reflect on both the situation and the people.* At the end of each project or performance cycle, think about things that might have pushed you or others into extrapunitive, impunitive, or intropunitive reactions. How did you respond? How did your colleagues? Was everyone on the same page? If not, why? What effect did situational and interpersonal factors have on the outcome?

The third strategy is to *think before you act.* When a failure seems to have occurred, don't respond immediately or impulsively. It's not always possible to right the wrong, but it's almost always possible to make things worse by overreacting in a highly charged situation. If you become extrapunitive, others may become impunitive. If you become intropunitive, others may pile on. Take the time to consider several possible interpretations of the event and to imagine various ways you might respond.

The fourth strategy is to *search for a lesson.* Mistakes happen. Sometimes a colleague or group of colleagues is at fault. Sometimes the responsibility lies with you. Sometimes no one is to blame. Look for nuance and context and then create and test hypotheses about why the failure happened, to prevent it from happening again.

When the talented chief technology officer of an internet company, a Skeptical type, discovered that his department's high turnover rate was caused by what employees described as an extrapunitive leadership style, he resolved to use these strategies. Previously he would excoriate his team if projects ran late or did not achieve their goals, refusing to listen to any explanations. The problem, he now learned, wasn't that his employees lacked competence; it was that they didn't always understand his instructions and were afraid to request clarification. So his first step was to check in with them to make sure everyone knew what he wanted. If results were unsatisfactory nonetheless, his initial response was still to criticize—but now he also spent time analyzing how the people and the situation had contributed to what went wrong. He started taking "deep dives" into failed projects, assigning blame only after careful consideration. Because of this approach, staff members began to share more information with him, which helped everyone identify weaknesses and oversights that had affected results. They also grew more comfortable telling him about minor problems earlier, making the problems less likely to cascade. Morale and productivity improved, and turnover decreased.

Let's look at how these strategies can benefit the other types. An executive who learns that he is coming across as impunitive, as the COO at the health care

nonprofit did, can ask others for feedback about whether the quality, quantity, and timeliness of work products represent success, failure, or something in between. Someone with intropunitive tendencies might make a list of all the situational factors that contributed to poor outcomes. Wendy eventually realized that she was hurting her career by taking too much responsibility for failure. So she started communicating more closely with her colleagues at the outset of a task to inoculate herself against worrying later on that she had acted without support. She pushed others to do their homework, share their opinions, and raise any objections; she also paid attention to subtle signals that she lacked consensus. The next time a drug trial she was involved in failed, she thought carefully about the reasons, soberly considered her role, and decided not to blame herself.

How to Influence Others

Just as important as understanding your own tendencies is recognizing when your bosses, peers, or subordinates might fit into the categories we've outlined. Having insight into their motivational biases and emotional reactions to failure can help you give them feedback in the right way and at the right time—feedback that increases their self-awareness and political awareness and ultimately helps them change their ways. Of course, sometimes dysfunctional people cannot be influenced; if this is the case with your boss, your best option may be to seek other career opportunities inside or outside your organization. However, people often conclude too quickly that their bosses can't change.

The chief of staff at an investment firm had an extrapunitive manager, a Cautious type, who was highly successful and widely respected in the industry but completely uninterested in personal improvement. Like the CTO described earlier, he gave little direction to his employees and then snapped at them when they failed to meet his deadlines or expectations. Although the chief of staff was not herself a victim of his outbursts, she sympathized with the junior executives who were. She identified one area of constant contention: questions about how to classify investments. The boss typically told staff members to "figure it out," and the time they spent doing so often led to delays in their analyses. She came up with a solution (forming a committee to create guidelines, which would then go to the manager for approval) and waited for the right time—when he was in a good mood and not too busy—to present it. He agreed, the committee was appointed, and things went more smoothly. The chief of staff had helped her colleagues and protected her extrapunitive boss from himself.

It's also possible to constructively influence people who have impunitive and intropunitive tendencies. Rather than criticizing his new COO publicly and making him defensive, the CEO at the health care nonprofit gave him supportive coaching. At the pharmaceutical company, George helped Wendy see the broader organizational context for the drug application's failure.

HANDLING FAILURE and blame the right way is key to managerial success. We believe the taxonomy we've presented will not only help you see your own role and responsibilities more clearly but also help you better understand the perceptions of others. And we hope this knowledge will enable you to approach failure with an open mind, react to it in a balanced and strategic way, and, most important, learn and help others learn from it.

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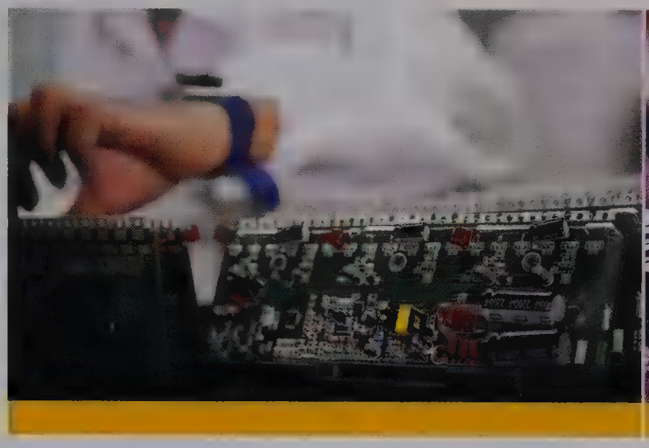
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Case Study: Healthcare Products

The healthcare industry is in the middle of rapid change. The sale of prescription drugs has grown by double digits in emerging markets such as Brazil, Russia, India, and China. In turn, a longer global chain of suppliers and customers makes distribution more complex, particularly as regulatory requirements vary from country to country. The biotech industry is creating a new wave of products that are fragile and demand temperature- and time-sensitive handling.

UPS's integrated global network is giving customers in pharmaceutical, biotech, and medical device businesses more flexibility to respond to new market opportunities, shifting distribution models, and changing regulations — all while delivering a better customer experience.

A multifunctional group of healthcare logistics experts who understand the industry's unique needs form a dedicated healthcare team at UPS. The team includes Quality Assurance personnel and a Regulatory Affairs group that maintains over 800 FDA, DEA, and varied state licenses. UPS logistics professionals on the team work closely with UPS customers to understand business challenges and recommend the right solutions and services.

For instance, for products that are time- and temperature-sensitive, UPS's Temperature True℠ air freight service helps maintain temperature control for door-to-door delivery. The service includes temperature-controlled handling and transportation capabilities via aircraft and refrigerated or validated trailers. UPS helps customers reduce unnecessary delays in global shipping with full customs brokerage and pre-determined contingency plans that put alternate routing in place if weather conditions or other events cause delays. Customers also have round-the-clock visibility with tools such as UPS Proactive Response℠, which couples a sophisticated monitoring engine with dedicated customer service agents to monitor critical shipments.

UPS has more than four million square feet of dedicated healthcare distribution space globally, which includes 30 facilities specially designed for health-care products. For companies with temperature-sensitive storage needs, UPS has multiple PDMA (Prescription Drug Marketing Act) and cGMP (current Good Manufacturing Practice) compliant distribution centers that offer validated-temperature and humidity-controlled environments, as well as controlled substance storage. UPS also possesses



Verified Accredited Wholesale Distributor (VAWD) certification for U.S. healthcare facilities.

For dealing with global distribution, UPS Order To Cash℠ capabilities can manage the entire healthcare product supply chain — from point-of-order entry to cash receipt. This service enables UPS customers to focus on their core business while UPS handles everything from customer service to warehousing and distribution to accounts receivable.

Case Study: High-Tech Industry

High-tech companies operate in a complex supply chain environment where fragile inventory, complicated products, rapid product life cycles, and narrow margins put constant pressure on market share and financial performance.

With the speed of product obsolescence increasing each year, there is a much smaller window of time to get merchandise to market — or risk taking a loss. And since most high-tech products are high value, inventory levels and security concerns are just as important as speed.

UPS high-tech solutions are focused on improving efficiencies and adding value from premanufacturing to post-sales support. UPS helps companies of all sizes keep the pipeline lean and flowing with a full suite of transportation, logistics, and customs brokerage services.

In the wake of the recent economic downturn, a survey of high-tech companies found that increased visibility into their supply chain and greater customer responsiveness are their top initiatives. UPS is a central source to help high-tech manufacturers drive post-sales efficiencies, improve business performance, and increase customer satisfaction.

For instance, the UPS Post-Sales Order Management System (OMS) allows companies located around the world to quickly assess their critical parts inventory, determine the most optimal routing strategy to meet customer needs, place orders online, and track parts from the warehouse to the end user.

With more visibility and control over global inventory and critical service orders, companies in industries such as high-tech can respond faster and more efficiently to customer needs. When a parts request is entered, the system gives companies access to real-time inventory data to locate the ideal warehouse to fulfill the request and then selects the best routing to meet deadlines.

This system provides visibility into the total delivery process, enabling users to see when the order is placed, picked up, on flight to a destination, delivered, and more. An automated e-mail or fax feature keeps customers informed of shipping milestones and can provide notification of changes to flight schedules for commercial airlines carrying their parts. In addition, "Closest Warehouse" functionality allows companies to identify the warehouse closest to the final destination for single or multiple parts orders. An "Inventory Inquiry" feature determines on-hand, reserved, and available inventory quantities by global warehouse location. Once orders are complete, companies can print documents such as labels and bills of lading in multiple languages, including Japanese and Chinese, making OMS a truly global solution.

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The Would-Be Pioneer

As a female American executive in South Korea, Linda Myers expected to open doors. Instead, she felt shut out. *by Sarah Green*

When Linda Myers accepted a human resources position at SK Telecom in South Korea, she thought it was the opportunity she'd long been working toward. Not only would she break ground as one of the first American female executives at a Korean company, she would also lead an initiative to make the organization more global. For someone who'd spent years consulting on expatriate transitions, this seemed like a dream job.

But as soon as Myers arrived in Seoul, she began to question her decision. Although she'd been in new cultural situations before, this one seemed more difficult to navigate. Without an official orientation or detailed guidance from her superiors, she struggled to understand the organization. She felt more isolated than she had expected: There were only a

few other Westerners on staff and just five other women at the VP level. Her straightforward American style was at odds with the polite formality of her Korean peers. And she eventually realized that she and her new employer had different ideas about what her role would be.

Over the next two years, exhilaration gave way to exhaustion. Rather than changing SK's culture, Myers felt marginalized—and then she was out of a job.

A Golden Opportunity

Myers had never heard of SK when a recruiter e-mailed her, in July 2007. "Dear Mr. Myers," the e-mail began.

"They assumed I was a man," she recalls. It was an innocent mistake, but it foreshadowed the misunderstandings to come.

At the time, Myers was a partner at WorldWise, a boutique consulting firm in Washington, DC, that helps multinationals such as Hewlett-Packard and ExxonMobil develop cross-cultural training programs. She loved the travel the position required—she'd spend a couple of months in, say, Ecuador or the Czech Republic—and a permanent foreign assignment seemed like a logical next step.

Myers's stints abroad had started early. At age 11, she'd spent time in Norway with the nonprofit Children's International Summer Villages. A junior year in London through a Goucher College program preceded a series of jobs involving extensive international travel. By the time she was 40, she had lived in, worked on, or traveled to all seven continents—even Antarctica.

One of these jobs had been with the China Human Resources Group, which facilitates joint ventures between U.S.-based multinationals and Chinese companies. When China was first opening up to international business, in the late 1980s and early 1990s, Myers prepped executives to work as expats there. She saw the job with SK as her chance to be an expat in Asia's fourth-largest economy, then growing by 5% per year. Like other Korean conglomerates (such as LG, Samsung, and Hyundai) SK Holdings—SK Telecom's parent, which has other subsidiaries in gas, construction, life sciences, and hospitality—was trying to become a more globally minded organization. To Myers, who had been the director of change management at Wyeth Pharmaceuticals before joining WorldWise, it seemed like a perfect fit.

The recruiter's initial e-mail marked the start of a six-month interview process, including trips to New York and Santa Clara, California. Follow-up e-mail communications stretched through the fall.

"I was working with a young man who spoke enough English to be the liaison for his boss, who spoke a little bit less English," Myers recalls. That was to be expected in negotiations with a Korean company for a job in Korea, but the two-language game of telephone sometimes led to confusion.

Still, she pressed ahead. In October, SK Telecom formally offered her a job. During a preliminary trip to Seoul in December, she was introduced as the new hire—even though, to her mind, she had not yet accepted the position. Feeling that this was her best opportunity to work abroad, she decided to take the leap.

Even with colleagues who spoke English, Myers found it difficult to get the information she needed.

Struggling to Fit In

On the ground in Seoul, Myers quickly realized just how far she was from her native Baltimore. One early shock was the homogeneity of not only her office but also the city: Government estimates indicate that foreigners account for 2.4% of the population. That's compared with just over 18% for Singapore and 27% for New York and London, according to the Migration Policy Institute.

Another surprise was her inability to communicate effectively. Myers had always considered herself to be skilled on this front: Born to deaf parents, by the age of three she was taking phone calls and translating between spoken English and American Sign Language. But her lack of Korean turned out to be a vexing problem. She recalls having to ask for an interpreter at her first meetings at SK. And even with an assistant and colleagues who spoke English, she found it difficult to get the information she needed. "Asking questions was the only way I knew to learn," she explains. "But it was not always productive." As she saw it, even diplomatic inquiries could be construed as confrontational and critical.

She was also unprepared for the company's rigid hierarchy. A spokesman for SK notes that "SK is recognized as one of the first Korean companies to abolish hierarchic management, [and] even at companies that have not, communication among employees is open and vibrant." But as Myers saw it, "there were basically four levels: VP, director, manager, and worker bee. You only talked to people at your level." Moreover, she was constantly aware of being female. Aside from secretaries, she was almost always the only woman in the room.

After the years Myers spent advising expats, perhaps she should have anticipated these challenges, but they were nonetheless difficult to handle.

Outside the office was a different story. She forged friendships in the expat community, soaked up local culture (sometimes literally, as with the Boryeong Mud Festival), and relished quiet time in her 33rd-floor apartment overlooking the Han River, downtown Seoul, and the peaks of Mount Bukhansan. Still, it was not easy to shake off the troubles at work.

Dae Ryun Chang, a professor at Yonsei School of Business in Seoul, says that Myers's situation was not uncommon,

noting that while big Korean conglomerates have wanted to recruit Western staff, there seems to be a disconnect in attitudes about work practices, particularly performance criteria, which in Korea "span not just formal key indices but informal and political ones."

In spite of these challenges, Myers advanced at SK. Four months after her arrival, she moved on to be head of Global Talent at SK Holdings. But leadership shake-ups changed the tenor of this role. Myers felt increasingly left out of key meetings and conversations, in part because language was still a problem, even though, according to SK, she by then had a mostly bilingual team, including three non-Koreans.

Although Myers saw her role as that of a change agent, she struggled to implement new practices and policies. "At the lower and middle levels, I think that people were very excited, very eager for change," she explains. "But at the top, most of the leadership was nervous."

Kim Tran, an SK Telecom employee originally from Vietnam, offers a more critical assessment: "She could have done certain things differently, but the result would have been the same. They didn't implement anything that she did—and she had some great ideas."

The SK spokesman disputed these characterizations. "We understand that living and working in Korea may have been challenging for [Ms. Myers] personally, but efforts were made on our side to ensure that all reasonably necessary assistance was not neglected."

By early 2009, Myers could tell she was on her way out. "My team leaders would barely speak to me," she says. Finally, her boss called her into his office and explained that although they had extended her contract once, they would not do so again.

In some ways, it was easy to leave SK. But Myers was disappointed not to have had an impact at the company and to be leaving a city she had come to love.

Hard-Won Wisdom

Looking back, Myers says her experience drove home several lessons. These were directives she had often given consulting clients, but like much good advice, they were easier to talk about than to implement.

First, learn as much as possible about the obstacles you'll face and acknowledge when they might be too much for you. Before Myers accepted the offer from SK, she asked the Society for Human Resource Management to put her in touch with another American woman who had worked for a Korean firm, but no one in their records fit that description. She realized too late the challenges of being a trailblazer. "There were no other examples," she laughs. "So I was self-taught."

Myers thought her superiors wanted her to overhaul the culture, but their ideas about change and how to execute it were completely different from hers.

However, her experience prepping clients to work for Western multinationals in China and other countries did not easily translate to her situation in Korea. She now says the reading she did before arriving covered only about a fifth of what she needed to know, and on-the-ground learning was tougher than she had imagined.

Second, understand your mandate. Myers took a job thinking her superiors wanted her to overhaul the culture at SK and stay with the company for the long term. But their ideas about change and how to execute it were completely different from hers, and they intended her stint to be relatively short. Ideally, these are points to iron out with a prospective employer during the interview process—even if it involves difficult questions, issued through a translator.

Third, don't let day-to-day misunderstandings bother you. "At times I felt I was misunderstood or treated unfairly because I was a foreigner." She points to a disagreement with a Korean peer about serving on a working group. Thinking it might have stemmed from a cultural misunderstanding, she consulted a third party. But when the peer heard she had done so, he was furious. "I had caused him great embarrassment," she remembers. After that, she tried to keep in mind that not every communication failure is a cross-cultural issue.

Fourth, take more time than you think you need to introduce new ways of working, even if the changes seem tiny. For example, early on she asked employees to dispense with calling her "Sang Mu Linda," her title at the company, and to use Linda, the norm in a U.S. company, to create a less formal environment. "But by removing the label, I plummeted in their eyes," she recalls. What she regarded as a "participative leadership style" looked wishy-washy to the people at SK.

Myers acknowledges the mistakes she made but does not regret accepting the position. "I knew I was taking a career risk," she says, "but the adventure, the contribution, and just the fact that I was there—as a foreign woman—were important."

She's since returned to consulting and—having struggled to practice what she once preached—now considers herself to be a better adviser. "Those years in Seoul taught me to question my own actions and assumptions," she says. "I realized that my leadership style had been shaped by a particular environment and that my way was not always best." ☐

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Sarah Green is an associate editor at *Harvard Business Review.*

Case Study

A complex project for the space station must come in on time and on budget—but the push for speed might be its undoing. *by Tom Cross*

A Rush To Failure?

The Experts



Gary L. Moe
Director, McKinsey Business Technology Office



Tom Quinly
President, Curtiss-Wright Controls

There is absolutely no reason why the contractors shouldn't be able to give us rapid product development and flawless products—speed and quality both," David MacDonagle said as he tried to light a cigarette. The warm wind, portending rain, kept blowing out his matches. Finally he gave up and slipped the cigarette back in his pocket.

MacDonagle, the head of the Canadian Aeronautics Administration, was nervous. Everyone at CAA headquarters was nervous. Very shortly, the project that many of them had devoted the past four years to would have its first real-world test, 350 kilometers above the earth. Feeling cooped up in the executive offices and oppressed by the presence of the media, MacDonagle had gone outside to breathe some air—actually, some tobacco smoke—and had invited the sharp young program manager Samantha Van Sant to join him.

Van Sant, a former Canadian army major, had a lot of skin in the project too. Since 2006 she'd been managing the two contractors the CAA had commissioned to build the $1.2 billion set of giant robotic arms known as Retractable Extended-Arms Compatible Holder, or REACH, for the International Space Station.

"So how do *you* deal with nerves?" MacDonagle asked.

"I usually go out for a run," Van Sant said, looking down the road that led from CAA headquarters through the cornfields, on which she'd logged many miles.

They turned to look back at the agency's buildings, which despite their grandeur looked small in the empty Quebec landscape. The sight reminded Van Sant of one of MacDonagle's catchphrases: "We are a small spacefaring nation...."

Canada was indeed a small player in space compared with the U.S., Russia, Europe, and Japan. Always at risk of being marginalized, the CAA had done everything possible to get the REACH contractors, Hollenbeck Aircraft and Eskina Software Systems, to complete the first phase of the project in time to get it to the space station this year, when the orbiting lab would officially be complete. And, amazingly, they had made the deadline—and come in on budget. REACH was now attached to the station, though there was still much more to come, including an even

HBR's case studies present fictionalized accounts of actual dilemmas faced by leaders, and offer solutions from experts.

more sophisticated set of "hands" that would fit on the ends of the robotic arms for extremely delicate work. The additions were to continue for two more years.

The contractors had been great about speed; the problem was quality. Glitches with the software, motors, and circuits had kept turning up. The fact was, not a single test in four years had gone flawlessly. "Yeah, yeah, we can fix that," the contractors' reps always said, dismissing the CAA's concerns. "Hey, this is life in the fast lane," a rep told Van Sant after one of REACH's arms had failed to retract on command. "Remember, we told you that the compressed schedule would increase the risk."

The contract that she managed called for parallel development, meaning that the project's phases—R&D, prototyping, testing, production, and quality control—overlapped, with each one beginning while the previous one was as much as 50% incomplete. That was sacrilege in some aerospace circles. But owing to the space station's construction deadline and the ever-present threat of cuts to the CAA's budget, the agency was aiming to do a decade's worth of work in six years. Computer simulations had to take the place of some real-world testing. Component quality control was less thorough. Because of all the unknowns in the project, the CAA had agreed to a cost-plus-fixed-fee contract, under which the contractors were paid a specified amount over their costs for labor, materials, and overhead.

MacDonagle's insistence on a rapid approach to development had been one of the main reasons Van Sant had been hired as a program manager. During her years in the army, she had established a bulletproof reputation for being aggressive and goal oriented. She and MacDonagle saw eye-to-eye. She knew speed was critical.

"We'd better go, I guess," MacDonagle said. "The media hounds are waiting. I told them I'd do quickie interviews once I got back. I know what they'll ask me: Is REACH going to work this time?" As they headed toward the building, the rain started. He looked at Van Sant. "So is it?"

> "I know what the media hounds will ask me: Is REACH going to work this time?" MacDonagle said.

Trouble in the Air

Red marker in hand, MacDonagle held forth before a group of reporters, asking whether they were aware that 50 years ago, the U.S. had blasted half a billion inch-long copper needles into orbit to reflect radio waves and thereby facilitate communications. Those needles were still floating around, and some had torn through one of the space station's solar collectors. "The solar arrays are the big bird's big red wings," he said, turning to the whiteboard and drawing the collectors.

He drew a gash in one of them. "A hole here means less electricity," he said, tapping the board. "Ever since the solar array got that hole from those flying needles, the space station has been operating on less power. Fixing it is tricky, because it's very far from the modules where the astronauts work and because of the risk of electrocution. Once an array is in place, you can't turn it off. It keeps generating power from sunlight. So if a spacewalker were to try to go out there and fix it, he'd be liable to get 100 volts of direct current through his body. That's where REACH comes in."

He took a moment to draw the Canadian creation, then stepped back to admire his sketch. The machine's two long arms stretched out toward the solar array in a nurturing embrace.

"Fixing solar arrays isn't what REACH was designed for," MacDonagle said. "It's meant to do the mundane work of replacing battery units on the exterior of the space station. But since REACH is up there, it's being pressed into service for the repair. It will stitch together the solar array while the astronauts control it from the safety of their module." He put the cap back on the marker and began fielding questions.

As Van Sant watched, someone tapped her on the arm. It was Alfred Siroy, the head of a CAA panel that had been trying to find out why there were so many quality issues with equipment from the Hollenbeck-Eskina venture.

"How long before they deploy it?" he asked.

"Soon—later—I'm not sure," she said.

Siroy always made Van Sant defensive. He'd made no secret of his disapproval of the way the REACH program was being managed, and of the parallel approach in particular. She knew that this viewpoint would figure in his forthcoming report. Fortunately, he was an overly meticulous writer, so the draft was taking forever. She asked him how the writing was going.

"Slow," he said, shaking his head. "But we do have a title: 'The Rush to Failure.'"

This gave her a start. "What failure?" she asked. "REACH is about to perform a critical repair task."

He shot her a skeptical look. "Rapid ramp-up was a laudable goal," he said. "But you have to give a contractor adequate time for QA. And you have to have a contract that gets the incentives right."

He continued: "We did an analysis. Your compressed schedule forces Hollenbeck-Eskina to cut corners, resulting in prototypes that fail. Substituting computer simulations for rigorous ground testing is a recipe for disaster. There isn't an electronic data management system that would allow the contractors and the CAA to access current test data for analysis. The prototypes aren't equipped with the instruments that would provide adequate test data. And the contractors have no incentive to push back: The cost-plus contract puts all the risk on the CAA. The agency and the contractors have different goals and objectives."

Van Sant couldn't disagree about the contract; its weaknesses had become increasingly evident to her. But if speed was the priority, they were unavoidable. "The contract language is ancient history," she said dismissively.

"You can rewrite history," Siroy said. "Any contract can be altered as long as both sides agree—you know that."

Suddenly, Van Sant saw, one of the staff members who'd been monitoring the goings-on at the space station began



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ushering MacDonagle away from the reporters, who, smelling blood, tried to follow. MacDonagle caught her eye, and Van Sant didn't like the look she saw on his face. Something bad had happened.

She slipped inside the communications room, where journalists weren't allowed, just before the door was shut. Over the speakers she could hear the astronauts at the space station talking about the power switching unit and using the word "failure." She heard someone say, "We have to go to Plan B."

REACH was probably experiencing the same problem that had come up during its last on-ground test. A system failure notification had gone off, but the contractors had dismissed it as a "reporting error," meaning it hadn't reflected a true mechanical breakdown. Still, no one wanted to deploy REACH while red lights were flashing. There was too great a risk that the robotic arms would fail at a critical moment.

"What's Plan B?" Van Sant asked MacDonagle.

"I don't know," he said quietly, "but whatever it is, it won't involve anything that came from us. REACH is Canada's only contribution to the space station."

Support from on High

"We've got video!" someone shouted, and there on the screens were multiple images of a man in a space suit dangling at the end of a loading crane.

It was well past midnight, but the reporters were still at CAA headquarters. They gathered around the screens. MacDonagle and Van Sant had long since given up trying to avoid them and were mingling with them as the repair attempt unfolded high above West Africa.

Everyone watched in silence as the crane, jury-rigged for the purpose, carried a spacewalker toward the space station's torn solar array. REACH couldn't even be seen—it was docked somewhere else.

"Harris Webb," MacDonagle said ruefully as he watched the figure in the shiny suit. "It's so fitting." Years ago, MacDonagle and Webb had been pilots on the same shuttle mission, and Webb, though much younger, had been chosen to lead it. A U.S. physician, mountaineer, author, pilot, and gourmet cook, as well as an astronaut, he was the ultimate go-to guy, brilliant and fearless—almost to the point of being foolhardy.

The reporters were excitedly discussing his stunt. Because REACH had failed, Webb was going out on the end of the crane to repair the array by hand. In one gloved hand he held what looked like an oversized hockey stick wrapped in insulation, so that he could stop himself from bumping into the arrays. In the other he carried several two-meter lengths of plastic cable that would be used to "stitch" the pliable solar array back together.

"Wow," a reporter gasped as Webb, reaching awkwardly, began threading one of the cables through the openings in the array.

"Cowboy," MacDonagle hissed under his breath. He put his hands on his head and looked at the ceiling.

Van Sant spotted Charlie Truss, one of the reps from Hollenbeck, sitting in a corner, his tie loose. He looked miserable. But she didn't feel pity for him—just annoyance. She went over to him.

"Whatever happens up there tonight," she said, "things are going to change down here. Our only way forward from this fiasco is to show that we've taken concrete steps to improve QA and finally get some positive results."

"I'm all for that," Truss said. "But anything you do to increase QA is going to slow things down. Once that happens, the costs start increasing and you become vulnerable to budget cuts. If we turn our existing contract into a traditional aerospace contract with all those sequential steps and inevitable delays, we might as well say good-bye to the improvements to REACH that are in the pipeline."

"If speed has to be sacrificed for a more reliable REACH, then so be it," Van Sant said. "The contract has major flaws. You're accountable for speed but not performance. We have to share the risk. We need a contract with performance-based incentives and penalties so that we can balance speed, quality, and results. Our goal is reliable components and systems that perform—and that should be your goal, too. We need to work as a unified team willing to push back on each other to get results."

Behind her the reporters gasped. She rushed to a screen and was relieved to see only that Webb, as he had finished his repair, had accidentally let go of a set of pliers, which was now drifting off into space.

But then Webb did something incredible. He turned to his Earth audience and began making a statement defending the failed REACH. "Everyone's going to blame REACH, but they shouldn't," he said. "It's a great piece of technology. I want to commend David MacDonagle and the CAA for overcoming a lot of technical obstacles in a big hurry and getting REACH up here on time. It's going to be a vital part of our operations. One little power-unit problem doesn't mean anything. Complex machines fail—that's just the way it is. We'll fix it, just like we fixed the solar array. I understand that the CAA has a great upgrade coming in the next couple of months—a new set of robot hands that are so nimble they can peel a hard-boiled egg. I say, Get it ready and shoot it up here. We'll start using it right away. I've got a few eggs that need peeling."

Van Sant was stunned, and she could see that Truss was, too. Then, giving her a small smile, he asked: "What were you saying about the contract?"



Tom Cross is a senior director in executive education at the University of Virginia's Darden School of Business, where he develops executive-learning programs for Department of Defense leaders. Previously he was a senior executive at such firms as KFC and Office Depot.

Should Van Sant push for a renegotiated contract for REACH?

See commentaries on the next page.



Gary L. Moe is a director in McKinsey's Business Technology Office and is based in Silicon Valley.

WHENEVER YOU hear about large, complex, costly government-sponsored tech initiatives that fail to meet expectations, the blame almost always falls on the "hurry up" schedule. If only the public agency hadn't pushed the contractors so hard, if only the developers had been given more time to refine the design, if only a few more months or years had been built into the production schedule, the technology would have worked perfectly. But it's not true.

Government sponsors can give contractors all the time and money in the world to complete a detailed requirements analysis and perfect a project design, and the finished product still probably won't work flawlessly. So-called big-bang design, in which developers labor mightily to get every last detail correct, is incapable of yielding a fully functioning, error-free product, because human beings, no matter how brilliant they are, cannot foresee all the issues that might arise in a complex technology.

What's needed instead is an iterative development process, whereby you build a prototype or even a fully fledged product and then put it out there, test it, and learn from its weaknesses, most of which you couldn't have seen on the drawing board

Human beings, no matter how brilliant, cannot foresee all the issues that might arise in a complex project.

or in a 3-D simulation. In the next iteration, you enhance the product. Then you run another round and another and another until finally you have something that works. The more complex a technology is, the more iterative the development needs to be.

This is how products are developed in the nongovernment sector. Take the auto industry. Cars are so complex that a manufacturer will put a model through a number of builds and a lot of testing before starting full production. In software, this process is called *agile development*. Developers write code for a week, test it to find out how to improve it, and then write some more code.

An interactive approach also works best when it comes to organizational change. No matter how hard you work on designing a reorganization, you will get it only 60% right, so you have to keep working at it, and finally you'll get to 90% right. (It never gets any better than that.)

Iterative development can work both for big long-term projects and for big one-offs, which is what many components of the International Space Station are. You break the development into pieces and apply the build-test, build-test method to the parts.

So why do government organizations, especially those that are defense- or space-related, favor the big-bang approach? There are a number of reasons, some involving the way procurement is handled. But the root of the problem is that iterative development entails experimentation, and experimentation entails failure. Government agencies don't like failure because it ruins political careers. So they try to avoid experimentation. But usually what they end up with is an even bigger failure—and no clue about why it happened.

My advice for Samantha Van Sant, then, is to restructure the contract to break further development of REACH into small chunks and require the contractors to practice iterative improvement, instead of striving for full initial functionality. Cutting down on the functionality delivered in each phase might help too, since 80% of cost and schedule overruns are usually due to the last 10% to 20% of requested functionality.

WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

YES, RENEGOTIATE. This contract is rife with problems. The project's phases overlap, and real-world testing is minimal. Most important, the project failed. Webb saved the agency's reputation and tempered the storm in the short term with his surprise comments. Now the CAA has to rework the contract to produce a successful product, because without one it will lose all momentum in its space efforts.

Tom Geiser, *managing partner, Black Twig Communications*

ALFRED SIROY offers excellent outside expertise. Samantha Van Sant and Charlie Truss would do well to seek out his advice, as he's interested in seeing REACH thrive but through a different approach that would not sacrifice quality. Contract reviewing is essential—but getting the right people in the project is the key success factor for REACH.

Bogdan M. Negru, *visiting lecturer, Griffiths School of Management, Emanuel University of Oradea*

IT'S TIME TO renegotiate, but the contractor would never accept a pure flat-fee arrangement, given the potential exposure. A cost-plus structure, with kickers for quality and speed and penalties for delays and problems, would probably work best. The project's very ambitious scope might be worth revisiting, too. Focus first on getting the basic arms working and later perhaps on making the hands capable of peeling a banana, not an egg.

Tom Leung, *senior vice president, Marchex*

HBR's case studies appear at **hbr.org** prior to publication here.



Tom Quinly is president of Curtiss-Wright Controls, based in Charlotte, North Carolina, which develops products for aerospace, defense, and industrial markets.

IN THE world of cutting-edge product development, the struggle between speed and quality is over. Speed has won—decisively. In today's highly competitive global markets, getting innovations out quickly can mean the difference between success and failure. But it's also a given that the quality must be high. Quality has become table stakes.

A lot of research has been published on the holy grail of lightning-speed development. Concurrent engineering programs, agile teams, risk mitigation programs, spiral development, outsourcing, harmonizing tools, and advanced simulation and modeling tools all can help you attain it, but your own people, processes, and market demands will determine the right recipe. What works best for us is forming small, seasoned, highly talented teams; being clear about time-to-market expectations; making sure developers have the right set of tools; and keeping our technical teams engaged, customer focused, and happy.

Bureaucracy, however, is an innovation killer. It's inevitable that as a business grows, things that don't add value creep into processes. With each slipup there's a tendency to add another process check. In isolation, each makes perfect sense, but in the aggregate, innovation is choked, and the team can't move nimbly.

I recall an experience early in my career, when a major development project had gone poorly. At an executive review, I was prepared to explain what had happened, what we'd learned, and what we'd done to stop the bleeding. Our CEO looked around at the others in attendance and said that he was disappointed—not in the group that had failed (mine), but in the other groups, because they *hadn't* failed. They weren't being as aggressive as he expected. That story lives on in the lore of the company, and it says a lot about our culture.

It's not that we encourage failure—we use it as a tool. Complex development programs rarely (if ever) come out of the gate perfectly; something unanticipated often happens. A lot can be learned from reviewing failures and looking at processes, expectations, people, and tools. Were our requirements too ambitious or ill defined? Did we not map the highest-risk areas and have well-designed mitigation plans? This relentless focus on learning improves predictability, reduces cycle time, and helps us get a high-quality offering to market ahead of the competition.

That's why I would advise Van Sant to give up the dinosaur perspective that speed means having to sacrifice quality.

The struggle between speed and quality is over. Speed has won—decisively.

She should engage the entire team in examining the failures and exploring ways to achieve quality without upsetting the schedule. If REACH has few qualified alternative partners, then disrupting a long-standing contract with a highly experienced and specialized partner would be counterproductive. If Hollenbeck-Eskina is the best option, I would avoid having to reopen the contract and potentially lose the partner's deep project knowledge. However, if Hollenbeck-Eskina was not totally engaged and forthcoming in helping understand and correct the failures, it may be time to involve other potential partners or to stand firm on a contract renegotiation.

HBR Reprint R1104N
Reprint Case only R1104X
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Grooming the Next Generation of Leaders

WHY TALENT IS KEY TO COMPETITIVE ADVANTAGE

LEADERSHIP DEVELOPMENT is a top priority for the coming year. Research by Oakland, California-based firm Bersin & Associates shows that companies with world-class leadership development clearly outperform companies with inconsistent development programs.

That may explain why leadership development programs were among the first programs to be put back on the priority list when the economy started to improve. In 2010, learning and development organizations spent 22 percent of their budgets on leadership development, after significant cuts in 2008, according to Bersin & Associates' *The Corporate Learning Factbook 2011: Benchmarks, Trends and Analysis of the U.S. Training Market.* The Leadership Development category includes executive development, management, and supervisory training, and other leadership-specific programs.

"This continued commitment to leadership development spending and the turnaround in corporate learning and development investment demonstrate business confidence in the coming year," said Josh Bersin, chief executive officer and president, Bersin & Associates. "Leading companies are now focused on globalization, agility, managing diverse and geographically dispersed workforces, driving innovation, and professional development for managers and leaders at all levels."

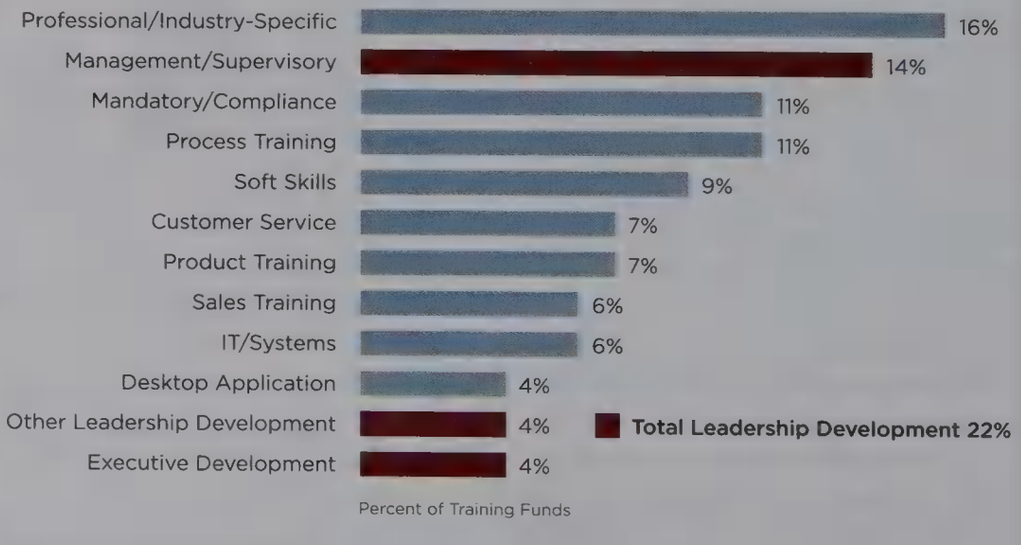
Bersin added that today's world-class learning and development department is very different from the corporate university of ten years ago. "We are at the beginning of a real renaissance in the industry," he said, "with a focus on social learning, informal learning, agile learning, and new media and formats to deliver content in a compelling way. Companies are recognizing that they need both formal and informal components to build deep levels of expertise and to better align the organization with business needs. That's how they're going to win."

Analysis of current world-class leadership development programs revealed these key trends:

MIX OF MEDIA, CONTENT, AND TRAINING

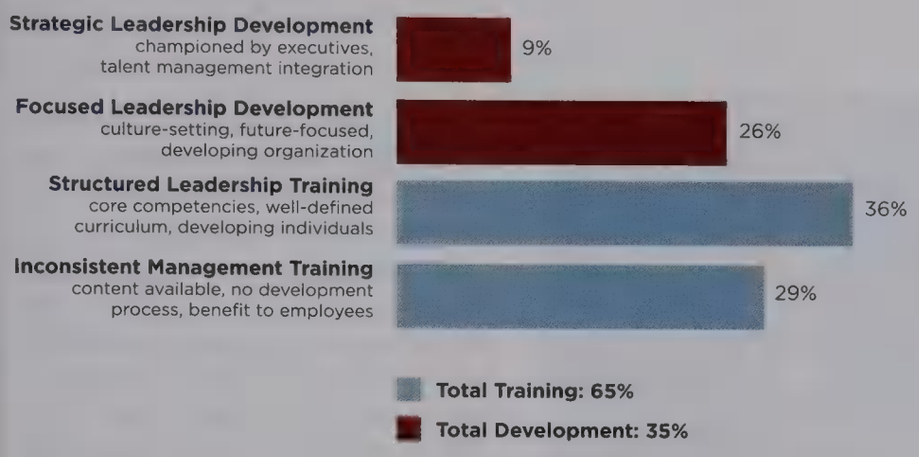
Today's business leaders exist in a world of mobile devices, laptop computers, and a wide range of online resources. Modern leadership development must go far beyond traditional, formal classroom activities to include the ability to practice and learn on the job in a blended program that includes relevant reading, videos, courseware, and internally developed

Training Program Spending Allocation 2010, U.S. Total



Source: Bersin & Associates, 2010

Leadership Development Maturity Model



Source: Bersin & Associates, 2008, http://www.bersin.com

materials—all arranged in an easy-to-find environment. The best programs feature an online portal that provides problem-solving tools, business principles, leadership and management tips, and recorded virtual sessions with respected faculty, authors, experts, and leaders. Executives and managers may use this information as part of a formal program, for their own personal development, or to solve specific problems.

A BUSINESS-RELEVANT, STRATEGIC PROGRAM FOR THE 21ST CENTURY

In the past, organizations looked for standardized leadership programs designed for people at all levels. "High-impact leadership development programs directly incorporate the capabilities that will define leaders of the twenty-first century," said Barb Arth, Senior Analyst, Leadership Development, Bersin & Associates. A focus on global leadership and emerging markets, business acumen, strategy alignment, and the ability to manage a diverse workforce that is multigenerational, multicultural, and multigeographical will be essential.

To meet these challenges, organizations need a strong leadership development partner with trusted content, the ability to build business-specific elements to customize the program, and the capability to deliver this customized content via leading-edge media modalities including simulations, participant-centered learning, coaching, and virtual collaboration. This partner also should be able to deliver the experiential learning exercises now favored for use with senior executives because they provide strong business impact. In fact, companies seek leadership development partners who offer targeted competencies that align directly with business goals.

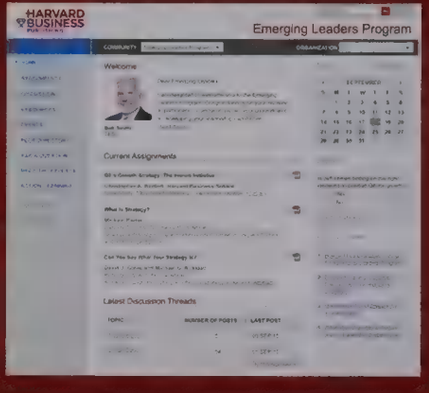
According to Bersin research, organizations with strategic leadership development programs simply deliver better results. These organizations deliver markedly greater financial returns, adapt more rapidly to changing business conditions, and endure turbulent business cycles. These companies are not just developing leaders. They are also creating sustainable organizations built to compete and win in the twenty-first century global business environment.

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Synthesis

A review of emerging ideas in the media



Constructive Confessions

The only useful lessons in entrepreneurial failure come from insider accounts. *by David Silverman*

History, it's often said, is written by the victors. And so it is in business. Scan the shelves of Barnes & Noble's business section, and you can find plenty of books about Bill Gates, Donald Trump, Larry Ellison, Warren Buffett, and their ilk.

However, while it's perfectly fine to hear about the fabulously successful, it's ultimately just an exercise in self-flagellation for us, the hoi polloi. There's very little to learn from comparing a successful person's crêpe suzette with one's own humble boiled egg.

Failure really is a better teacher than success, though not in the way we usually think. Certainly if I drop a cordless drill on my toe, I learn to use more-effective foot protection when doing home repairs. (I'm currently wearing a bandage on my big toe.) That's the cause-and-effect value of failure, and it's not what the real lesson is. When you've been knocked down time and again, you learn how to deal with setbacks, which ultimately come to every one of us. You don't figure out how to stop making mistakes; you figure out how to recover from them quickly. As the superintendent in my apartment building always says, "The master carpenter makes as many mistakes as the amateur, but he fixes them faster."

What any aspiring business leader really wants is first-person accounts from people who did it wrong—who ran the proverbial train into the abyss and, as a result, can explain how to bring it back. These, it turns out, are hard to come by. I myself am the author of one such story—*Typo: The Last American Typesetter or How I Made and Lost 4 Million Dollars* (Soft Skull Press, 2007). In that book I describe how I ruined a 50-year-old typesetting company in Iowa with 200 employees and $12 million in revenue. And in the efforts of trying to publish it, I learned why most people don't write books like this: Industry buyers think nobody wants to read them. As my publisher, Richard Nash, explained, "All the evidence suggests that business books are not in fact about learning, but about escapism, just like a romance novel. The business book is about imagining yourself a success, not making yourself a success through learning from failure."

What I have found in print tends to fall into three categories. The first is the rare case of a journalist who managed a business to failure and felt comfortable writing about it. James Ledbetter tells the tale of the *Industry Standard*'s collapse in *Starving to Death on $200 Million* (Public Affairs, 2003). It's a good story about the boom and bust of the turn-of-the-century internet era, but it's ultimately not very fulfilling on the "what we learned" front.

The second is the MBA graduate who can't quite understand why he or she failed and has to express that confusion in ink. John Lusk and Kyle Harrison's book, *The MouseDriver Chronicles: The True-Life Adventures of Two First-Time Entrepreneurs* (Perseus, 2002), is the story of their misguided attempt to make computer mice that looked like golf-club heads. The product itself wasn't the problem; both novelty golf items and computer accessories are popular retail categories, and there are plenty of overlaps

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As a matter of policy, we don't review our own books, but check out our "New Books from the Press" blog post each month at **blogs.hbr.org/synthesis**.

in the customer base. No, Lusk and Harrison's venture was doomed because they partnered with an overseas manufacturer that made unexpected mistakes, they underestimated how much time it would take to cajole distributors and shops to deal with them, and they struggled to cut their costs quickly enough. Now, I may be guilty of degree envy, criticizing someone with more schooling than I have. But the reality is that an MBA can convince people they know things they don't, such as how to effectively develop and sell products. Lusk and Harrison learned a lot more about business management from having piles of poorly manufactured computer mice pile up in their homes than they did from their classes at Wharton.

And the third is the "Yes, I failed, but I got over it" story found in almost every successful person's biography. My personal favorite is Gordon Ramsay's *Roasting in Hell's Kitchen: Temper Tantrums, F Words, and the Pursuit of Perfection* (HarperCollins, 2006), where Ramsay recounts ignominious moments like the time he tried to drum up publicity by stealing his own restaurant's reservation book and pretending it was an evil plot by the competition. Ramsay is the epitome of someone whose career was forged in failure. He dreamed of being a professional soccer player and made it on to a top team. But then he injured his leg and was permanently sidelined. Working his way up from kitchen staff helper to chef to restaurant owner to media celebrity, he endured fallings-out with longtime partners, funding crises, and failed venues, not to mention all the little day-to-day takedowns from staff members, customers, reviewers, and suppliers. It may be tempting now to say that he is a bully or that he's turned into the kind of vapid celebrity chef he used to despise. But that would be incorrect. He's worked hard for what he has and suffered many setbacks along the way. And, by all accounts, he still understands, and teaches others (albeit rather brutally), that there is no success without the taste of failure easily remembered.

> "Quickly it became all too apparent that the condom key chain was no Pet Rock."
> Robert Strauss, *Ahead of My Time*

On the internet, people seem much more comfortable expressing their missteps, and there's no sales-focused editor or publisher forcing them to filter this deeply personal angst. ChubbyBrain has collated a great set of stories, including one from Marc Hedlund, founder of personal finance website Wesabe, who blogged this insightful gem to explain why his company was beaten by Mint.com:

"You'll hear a lot about why company A won and company B lost in any market, and in my experience, a lot of the theories thrown about—even or especially by the participants—are utter crap. A domain name doesn't win you a market; launching second or fifth or tenth doesn't lose you a market. You can't blame your competitors or your board or the lack of or excess of investment. Focus on what really matters: making users happy with your product as quickly as you can, and helping them as much as you can after that. If you do those better than anyone else out there you'll win."

Or there's the post in Robert Strauss's blog, *Ahead of My Time,* which recounts the graphic moment when the would-be inventor realizes, several weeks and thousands of dollars too late, that condoms in air cargo holds depressurize and leak unwashable goo onto everything around them. That's pretty much all you need to know about what can go wrong as a start-up.

While it's tempting to think that each tale of entrepreneurial woe would be unique, that's not the case. As a failed American dreamer myself, I saw in all the books, chapters, and posts the same core set of "mistakes":

- I didn't have enough experience—now I know.
- I thought I knew everything—I did not.
- I thought it (selling toasters, watering lawns) was going to be easy—it was extremely hard.
- People (customers, employees, partners, investors) are reluctant to change what they're used to—I didn't sell anyone anything.
- I forgot to try to make money.

From all these examples, in print and online, the message is clear: Failure happens; it's what you take from it that makes the difference between a fall and a stumble. With one, you hit the ground and stay there; with the other, you regain your footing and keep running. Or, to quote from an executive who has overcome adversity, Soichiro Honda, founder of Honda Motor Company, "Success is 99% failure."



Starving to Death On $200 Million
James Ledbetter
Public Affairs, 2003



The MouseDriver Chronicles: The True-Life Adventures Of Two First-Time Entrepreneurs
John Lusk and Kyle Harrison
Perseus, 2002



Roasting in Hell's Kitchen: Temper Tantrums, F Words, And the Pursuit of Perfection
Gordon Ramsay
HarperCollins, 2006

ChubbyBrain

ChubbyBrain
Created in June 2008

David Silverman has had ten careers so far, including entrepreneur, executive, college professor, and writer. He hopes the majority of his failures are behind him.



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Executive Summaries April 2011

THE FAILURE ISSUE



The articles in this themed issue outline common types of failure, show how to learn from failure (and explain why people usually don't), examine why misbehavior is tolerated, describe designing "intelligent failures," consider whether resilience can be taught, offer advice on gracefully taking blame, and more.

UNDERSTANDING FAILURE

Strategies for Learning From Failure

Amy C. Edmondson | page 48

Many executives believe that all failure is bad (although it usually provides lessons) and that learning from it is pretty straightforward. The author, a professor at Harvard Business School, thinks both beliefs are misguided. In organizational life, she says, some failures are inevitable and some are even good. And successful learning from failure is not simple: It requires context-specific strategies. But first leaders must understand how the blame game gets in the way and work to create an organizational culture in which employees feel safe admitting or reporting on failure.

Failures fall into three categories: preventable ones in predictable operations, which usually involve deviations from spec; unavoidable ones in complex systems, which may arise from unique combinations of needs, people, and problems; and intelligent ones at the frontier, where "good" failures occur quickly and on a small scale, providing the most valuable information.

Strong leadership can build a learning culture—one in which failures large and small are consistently reported and deeply analyzed, and opportunities to experiment are proactively sought. Executives commonly and understandably worry that taking a sympathetic stance toward failure will create an "anything goes" work environment. They should instead recognize that failure is inevitable in today's complex work organizations.

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Ethical Breakdowns

Max H. Bazerman and Ann E. Tenbrunsel | page 58

Companies are spending a great deal of time and money to install codes of ethics, ethics training, compliance programs, and in-house watchdogs. If these efforts worked, the money would be well spent. But unethical behavior appears to be on the rise. The authors observe that even the best-intentioned executives may be unaware of their own or their employees' unethical behavior. Drawing from extensive research on cognitive biases, they offer five reasons for this blindness and suggest what to do about them.

Ill-conceived goals may actually encourage negative behavior. Brainstorm unintended consequences when devising your targets.

Motivated blindness makes us overlook unethical behavior when remaining ignorant would benefit us. Root out conflicts of interest.

Indirect blindness softens our assessment of unethical behavior when it's carried out by third parties. Take ownership of the implications when you outsource work.

The slippery slope mutes our awareness when unethical behavior develops gradually. Be alert for even trivial infractions and investigate them immediately.

Overvaluing outcomes may lead us to give a pass to unethical behavior. Examine good outcomes to ensure they're not driven by unethical tactics.

HBR Reprint R1104C

Why Leaders Don't Learn From Success

Francesca Gino and Gary P. Pisano | page 68

"Success can make us believe that we are better decision makers than we actually are."

What causes so many companies that once dominated their industries to slide into decline? In this article, two Harvard Business School professors argue that such firms lose their touch because success breeds failure by impeding learning at both the individual and organizational levels.

When we succeed, we assume that we know what we are doing, but it could be that we just got lucky. We make what psychologists call *fundamental attribution errors*, giving too much credit to our talents and strategy and too little to environmental factors and random events. We develop an *overconfidence bias*, becoming so self-assured that we think we don't need to change anything. We also experience the *failure-to-ask-why syndrome* and neglect to investigate the causes of good performance.

To overcome these three learning impediments, executives should examine successes with the same scrutiny they apply to failures. Companies should implement systematic after-action reviews to understand all the factors that led to a win, and test their theories by conducting experiments even if "it ain't broke."

HBR Reprint R1104D

LEARNING FROM FAILURE

Failing by Design

Rita Gunther McGrath | page 76

It's hardly news that business leaders work in increasingly uncertain environments, where failures are bound to be more common than successes. Yet if you ask executives how well, on a scale of one to 10, their organizations learn from failure, you'll often get a sheepish "Two—or maybe three" in response. Such organizations are missing a big opportunity: Failure may be inevitable but, if managed well, can be very useful. A certain amount of failure can help you keep your options open, find out what doesn't work, create the conditions to attract resources and attention, make room for new leaders, and develop intuition and skill.

The key to reaping these benefits is to foster "intelligent failure" throughout your organization. McGrath describes several principles that can help you put intelligent failure to work. You should decide what success and failure would look like *before* you start a project. Document your initial assumptions, test and revise them as you go, and convert them into knowledge. Fail fast—the longer something takes, the less you'll learn—and fail cheaply, to contain your downside risk. Limit the number of uncertainties in new projects, and build a culture that tolerates, and sometimes even celebrates, failure. Finally, codify and share what you learn.

These principles won't give you a means of avoiding all failures down the road—that's simply not realistic. They *will* help you use small losses to attain bigger wins over time.

HBR Reprint R1104E

THE GLOBE

LEARNING FROM FAILURE

"I Think of My Failures As a Gift"

A.G. Lafley, former CEO of P&G Interviewed by Karen Dillon | page 86

Lafley, the former CEO of Procter & Gamble, is regarded as one of the most successful chief executives in recent history. But like everyone else, he's had his share of mistakes. Politicians and winning sports teams draw their biggest lessons from their toughest losses, he says, and the same has been true for him.

P&G learned more from its failed new brands and products than from its successes. Among Lafley's favorite examples is the color-safe, low-temperature bleach that the company test-launched in the 1980s under the brand name Vibrant. P&G chose Portland, Maine, as the test market, hoping to escape notice from Clorox, which was headquartered in Oakland, California. But Clorox got wind of the plan in time to distribute free gallons of Clorox bleach to every household in Portland, making all P&G's advertising dollars, sampling, and couponing irrelevant. "Game, set, match to Clorox," Lafley says. But the good technology behind Vibrant remained, and when Clorox tried to enter the laundry detergent business a few years later, P&G modified that technology to create Tide with Bleach, which grew into a business worth more than half a billion dollars.

Lafley also talks about systematically analyzing 30 years' worth of failed acquisitions to uncover five root causes for their lack of success: no winning strategic reason for the acquisition; integrating poorly or too slowly; expecting synergies that didn't materialize; incompatible cultures; and company leaders who "couldn't play together in the same sandbox." That analysis led to changes that informed P&G's highly successful acquisition of Gillette in 2005.

HBR Reprint R1104F

How to Avoid Catastrophe

Catherine H. Tinsley, Robin L. Dillon, and Peter M. Madsen | page 90

Near misses preceded every disaster we studied, and most of them were ignored.

Most business failures—such as engineering disasters, product malfunctions, and PR crises—are foreshadowed by near misses, close calls that, had luck not intervened, would have had far worse consequences. The space shuttle Columbia's fatal reentry, BP's Gulf oil rig disaster, Toyota's stuck accelerators, even the iPhone 4's antenna failures—all were preceded by near-miss events that should have tipped off managers to impending crises. The problem is that near misses are often overlooked—or, perversely, viewed as a sign that systems are resilient and working well. That's because managers are blinded by cognitive biases, argue Georgetown professors Tinsley and Dillon, and Brigham Young University's Madsen.

Seven strategies can help managers recognize and learn from near misses: They should be on increased alert when time or cost pressures are high; watch for deviations in operations from the norm and uncover their root causes; make decision makers accountable for near misses; envision worst-case scenarios; be on the lookout for near-misses masquerading as successes; and reward individuals for exposing near misses.

HBR Reprint R1104G

RECOVERING FROM FAILURE

Building Resilience

Martin E.P. Seligman | page 100

Failure is a familiar trauma in life, but its effects on people differ widely. Some reel, recover, and move on with their lives; others get bogged down by anxiety, depression, and fear of the future. Seligman, who is known as the father of positive psychology, has spent three decades researching failure, helplessness, and optimism. He created a program at the University of Pennsylvania to help young adults and children overcome anxiety and depression, and has worked with colleagues from around the world to develop a program for teaching resilience. That program is being tested by the U.S. Army, an organization of 1.1 million people where trauma is more common and more severe than in any corporate setting. Nevertheless, businesspeople can draw lessons from resilience training, particularly in times of failure and stagnation.

The program is called Comprehensive Soldier Fitness, and it has three components: the Global Assessment Tool, a test for psychological fitness (administered to more than 900,000 soldiers to date); self-improvement courses following the test; and "master resilience training" (MRT) for drill sergeants. MRT focuses on enhancing mental toughness, highlighting and honing strengths, and fostering strong relationships—core competencies for any successful manager.

HBR Reprint R1104H

How China Reset Its Global Acquisition Agenda

Peter J. Williamson and Anand P. Raman | page 109

China's economic progress has been so dazzling that people often forget that China Inc. has seen its share of failures too. Just look at the first cross-border acquisitions that Chinese companies made. Many of those high-profile deals—including TCL's acquisition of France's Thomson, SAIC's takeover of South Korea's Ssangyong Motor Company, and the D'Long Group's purchase of America's Murray, Inc.—ended badly. But for the Chinese, failure is not about falling down; it's about refusing to get up. They quietly changed course, altering the kinds of targets they pursued and their rationale for M&A.

Chinese acquirers have learned to steer clear of deals that involve costly turnarounds or tricky integration. Instead of buying brands, sales networks, and goodwill, they now look for hard assets, like mineral deposits and oil reserves, or state-of-the-art technology and R&D. And where they once tried to buy market share abroad, today they focus on acquisitions that will help them strengthen their share in China. Most telling of all, they're more willing to walk away—perhaps one of the surest signs of M&A sophistication.

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How I Did It

LEADERSHIP

Blockbuster's Former CEO on Sparring With an Activist Shareholder

John Antioco | page 39

When Antioco joined Blockbuster, in 1997, outsiders were predicting that the bricks-and-mortar video rental business would be killed off by market shifts and technological advances. But he believed the company could remain relevant.

First he needed to revise Blockbuster's business model, which was built on buying individual VHS cassettes at a hefty price and then struggling to rent each one about 30 times to make back the money. Antioco's team persuaded the movie studios to shift to a revenue-sharing system. Then the company jumped into the online business and eliminated its late fees, which had been a major customer irritant. Five years into Antioco's tenure, Blockbuster's revenues had nearly doubled.

Enter Carl Icahn, activist shareholder, who had his own ideas about how Blockbuster should



be managed and particularly about Antioco's compensation package. Icahn launched a successful proxy fight and secured seats on the board for himself and two others, putting Antioco on the defensive over his strategies for growth. The situation finally came to a head in a boardroom dispute over his bonus—resolved by his departure six months later. Three years after that, Blockbuster filed for bankruptcy.

Icahn offers his version of events in a sidebar to the article.

HBR Reprint R1104A

Managing Yourself

Can You Handle Failure?

Ben Dattner and Robert Hogan | page 117



Handling failure and blame is key to managerial success. But roughly 70% of Americans have a personality type that tends to react inappropriately when things go wrong. Some people are *extrapunitive,* always pointing a finger at someone else. Others are *impunitive,* denying there's a problem or that they played any role. And still others are *intrapunitive,* heaping too much blame on themselves and seeing disasters where none exist.

Fortunately, there are ways to fix such flawed responses. The first step is to cultivate self-awareness; several personality tests can help you assess your interaction style. Next, deepen your political awareness to better understand what messages others are receiving.

Once you've identified your bad habits, you can move toward more-adaptive responses. Dattner and Hogan describe several strategies that can benefit any of the personality types. You should make sure to listen and communicate well, reflect on the situation and the people involved, think carefully before acting, and look for lessons when mistakes do happen.

Using detailed examples, the authors illustrate how people with the various personality types are apt to react to specific failures and explain what they might do differently. They also offer insights to help you recognize when your bosses, peers, or subordinates fit into one of the problematic categories and suggest ways to influence their behavior. The taxonomy and tactics they present will help you approach failure with an open mind and react in a balanced, constructive way.

HBR Reprint R1104L

Failure Chronicles

Seven CEOs, entrepreneurs, and venture capitalists tell stories of personal failures—and what they learned from them.

56 | **Doug Rauch**, a former president of Trader Joe's, admits to being a "control-aholic" and recounts how his micromanagement hindered the chain's East Coast expansion.

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Life's Work

To read the extended interview, go to **hbr.org/gervais**.

Ricky Gervais was 40 years old when his British television mock-documentary *The Office* became a hit, in 2001. The former student-union events manager has gone on to write, produce, direct, and perform in another hit show, *Extras;* several Hollywood films; four sellout comedy tours; and a podcast series that is the most downloaded in the world—most of that work in collaboration with partner Stephen Merchant. He hosted the 2010 and 2011 Golden Globes awards ceremonies, courting controversy both times.
Interviewed by Alison Beard



HBR: Why was *The Office* such a success?

Gervais: It was a setting everyone knew. It was about being thrown together, wanting to belong—all those things everyone identifies with immediately, and it doesn't matter if you're in Slough or Scranton or Israel or any other place *The Office* is remade. I worked in an office for seven years. I started off on reception, then I was assistant to the manager, and then I became middle management. I knew what it was like. David Brent was a Frankenstein of those people I've met who worry more about their reputation than their character. His worst crime was mistaking popularity for respect. And I nailed it.

What sort of boss are you?

Well, hopefully, a lot more self-aware than Brent. It's funny because in my previous job I went to management training and I was cynical. But then I quite got into team building and realized I was doing it intuitively. I did like creating a fun place to work, and I knew that the most important thing is to be up-front and fair. Then, people might not like what you do because they're not getting the thick end of the wedge, but they can't have you on it.

You insist on complete creative control, right?

Yes, I'm a complete fascist, and you should be in art. I don't think I'm the best producer or director or actor in the world, but I know how I want it done. I don't try to please anyone except myself. And if people like what I do, fantastic. If they don't, that's good, too. If you water it down, you end up with something so homogenized that a lot of people will like it, but they won't love it. And I've always preferred to do something that really moves a million people than something that washes over 10 million.

Explain how you work collaboratively.

Well, with Stephen, two heads are better than one, and it's fun. But there's a compromise, which is bad. So we have this golden rule: With any idea, one veto and it's out. We don't have to justify why we don't like it. It just goes. Of course, the cutting room floor is knee-deep. But the finished product, we're both proud of, not only at the time, but also in 25 years' time. With stand-up, I've got a room of 10,000 collaborators and critics. My act is an evolution, where the audience chooses the best bits. If they don't laugh, the joke doesn't survive.

Why do you work so hard?

My dad was a laborer who got up at 5:30 each morning and worked for 50 years in all weathers for, by showbiz standards, petty cash. And I remind myself of that. Winston Churchill said if you find a job you love, you'll never work again. And that's what it feels like. I used to be a lazy person, unambitious, a slacker, but now I'm a workaholic, because of the privileged position I've found myself in. Fame is an upshot of what I do. But it's not the driving force. The making of it is the fun for me—not the money or the awards. I've never done anything for a million pounds that I wouldn't have done for free.

Tell me about a time you failed.

Well, I certainly failed at being a pop star because I wasn't doing what I wanted, I was doing what I thought would be successful. I deserved to fail. And I'm glad I did, obviously.

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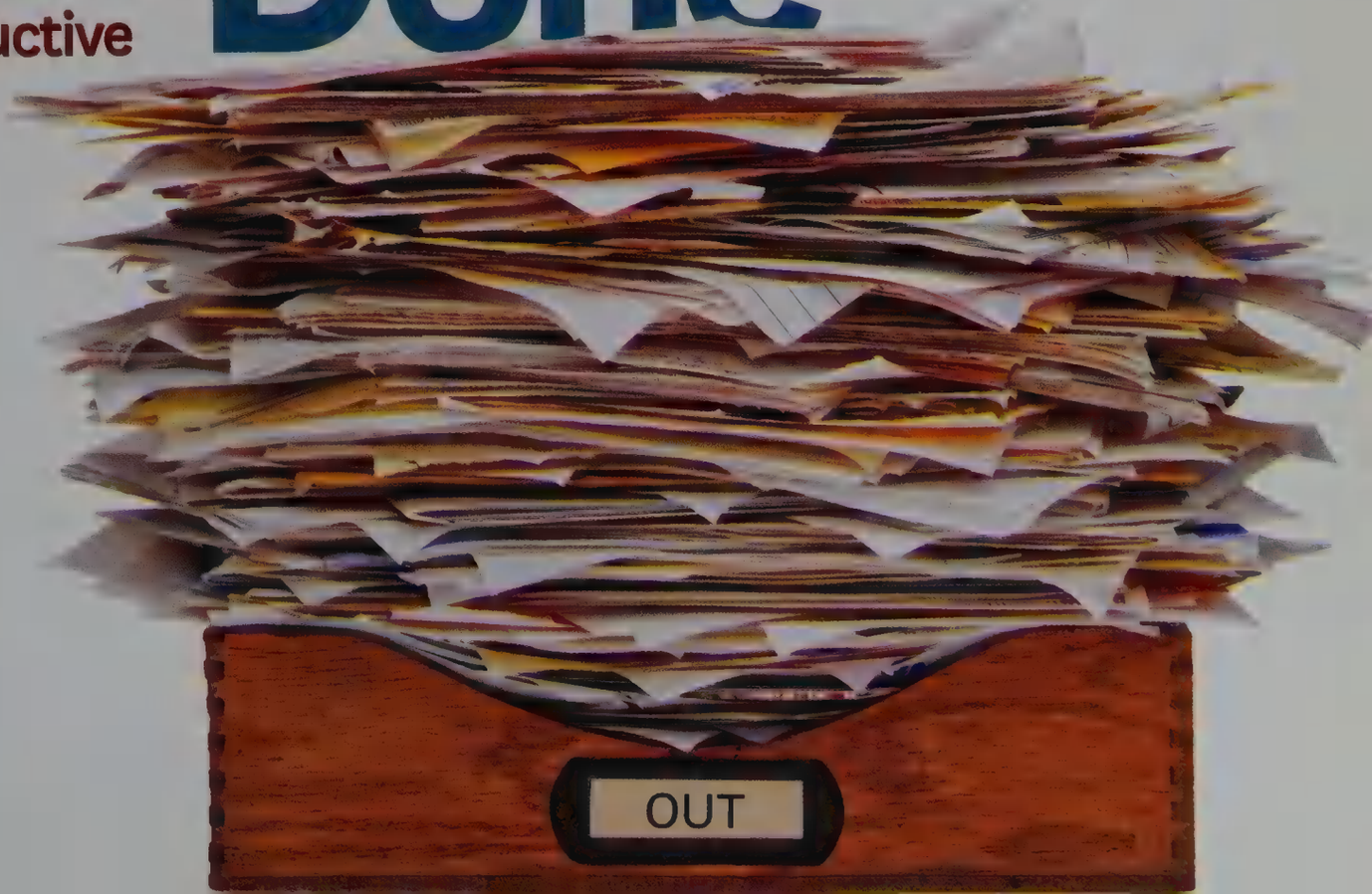
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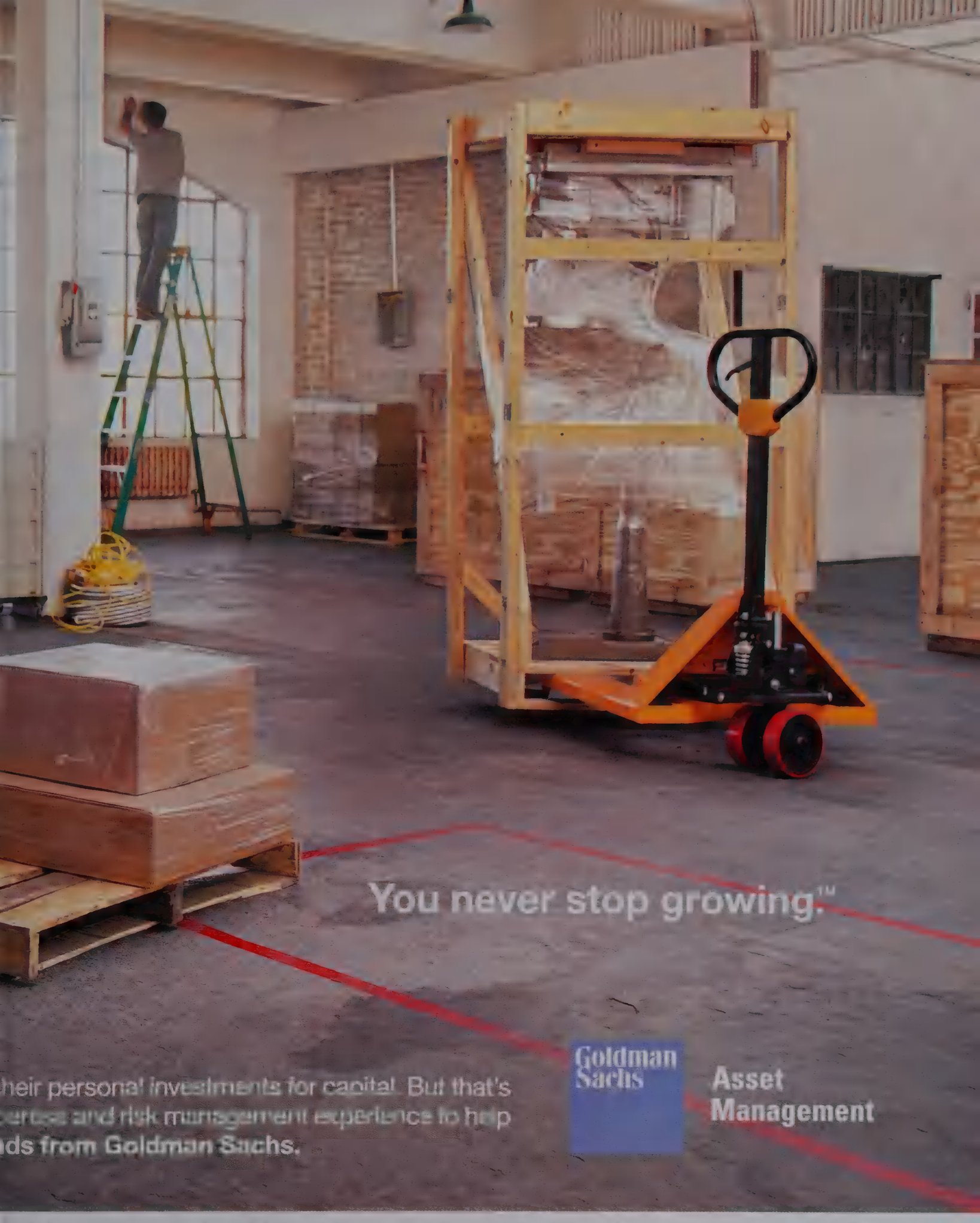
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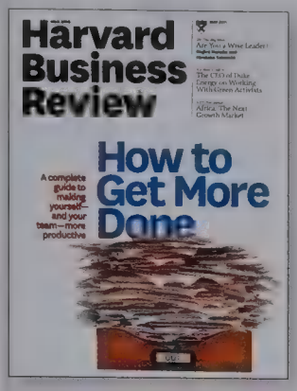
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About the Spotlight Artist

Xavier Veilhan was born in Lyon, France, in 1963 and lives in Paris. His sculpture, photography, and installations have been shown in group and solo exhibitions around the world since 2000, recently at the World Expo 2010 in Shanghai.

Acutely aware of his place in the history of art, Veilhan says he likes to make things himself and is influenced by nearly every movement. His life-size and oversize sculptures, such as a Ferrari-red rhinoceros, deal with the physical experience as well as the visual impact, arresting an audience with the perceived differences between the real and the representative.

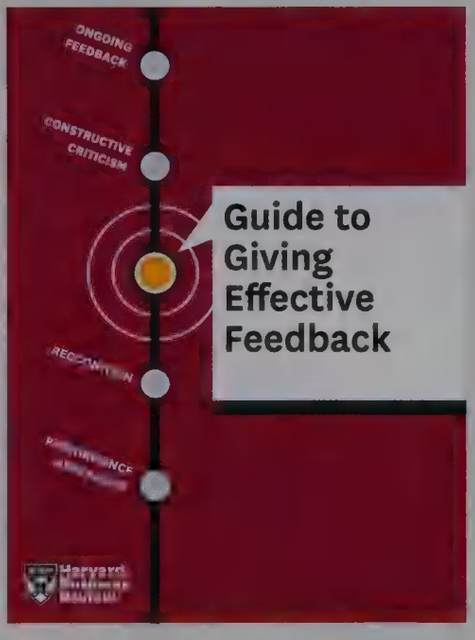


ABOVE
Xavier Veilhan
The Big Mobile
2004, metallic structure, 25 spheres in PVC with diameters from 29.5" to 137.8", exhibition view, Art Gallery of Ontario, Luminato Festival, Toronto

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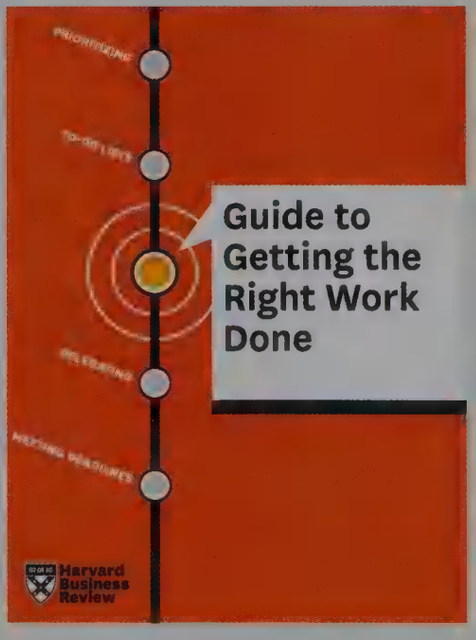
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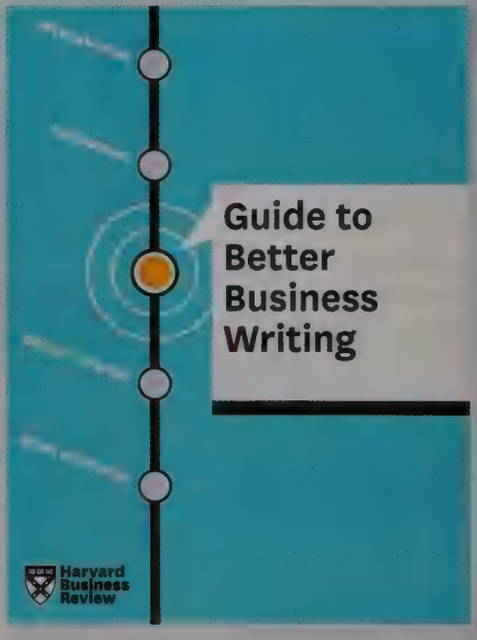
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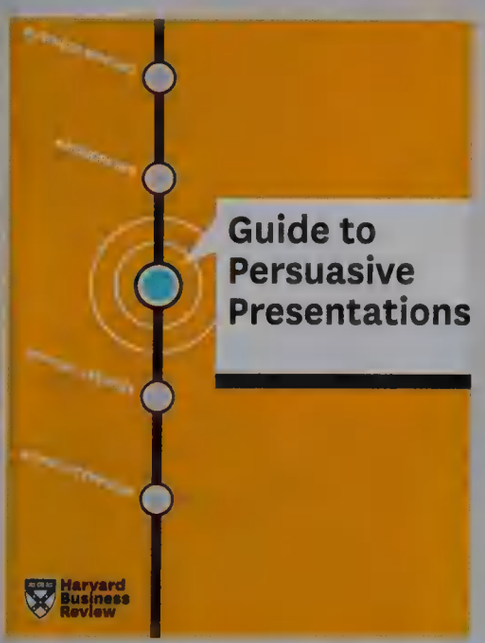
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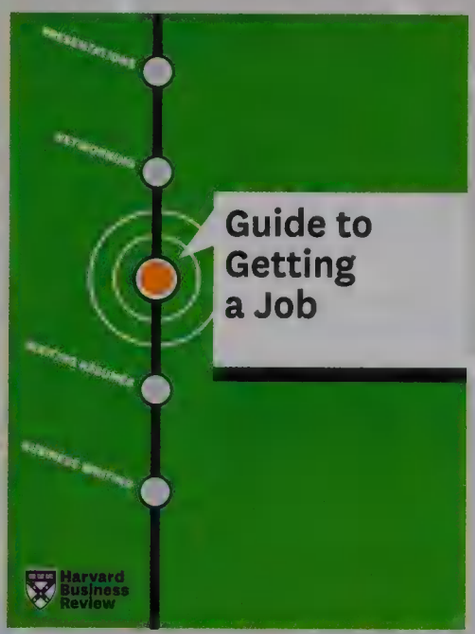
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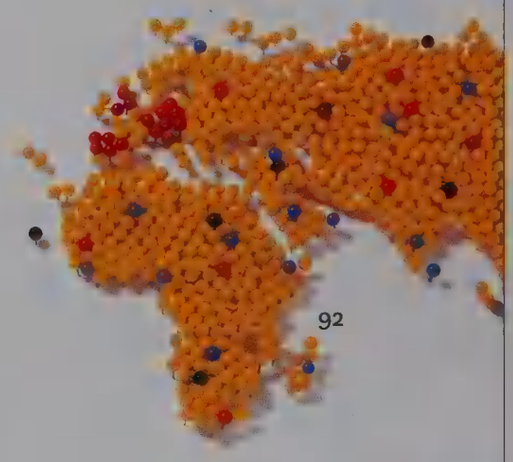
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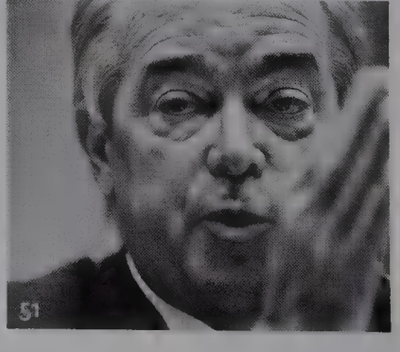

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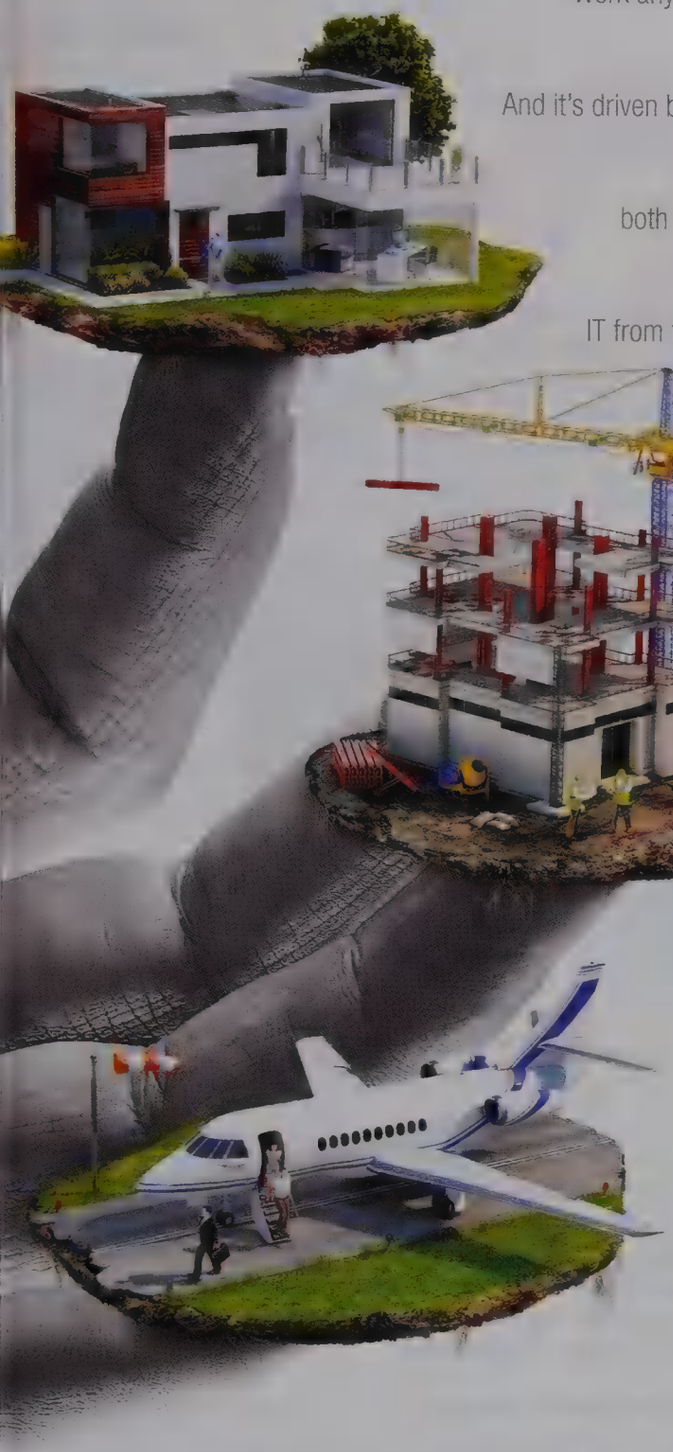
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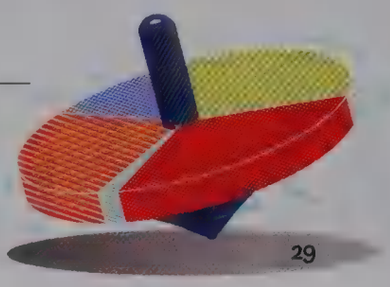
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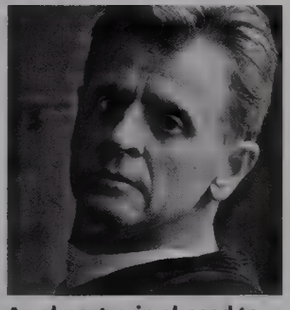
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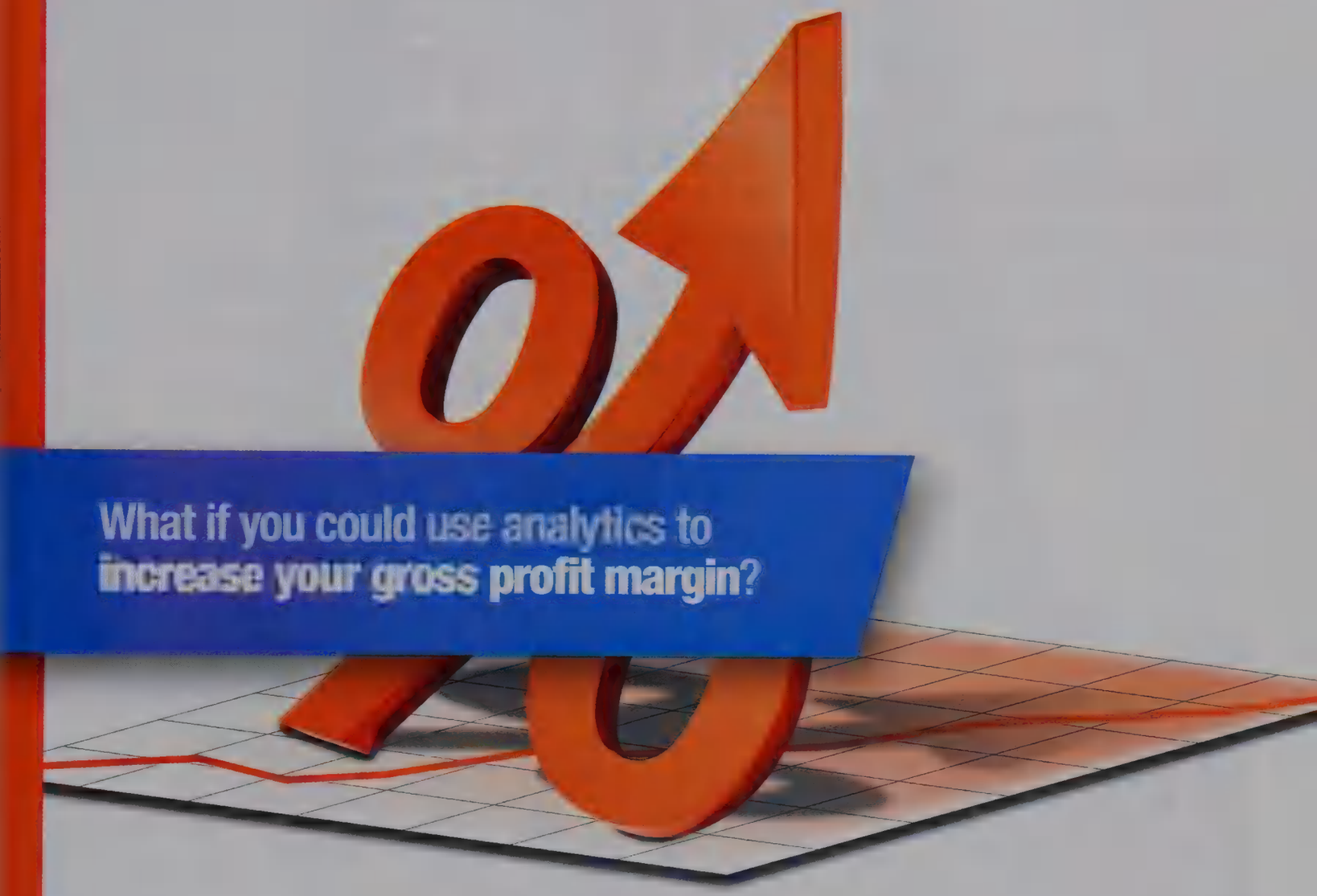
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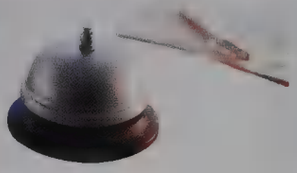
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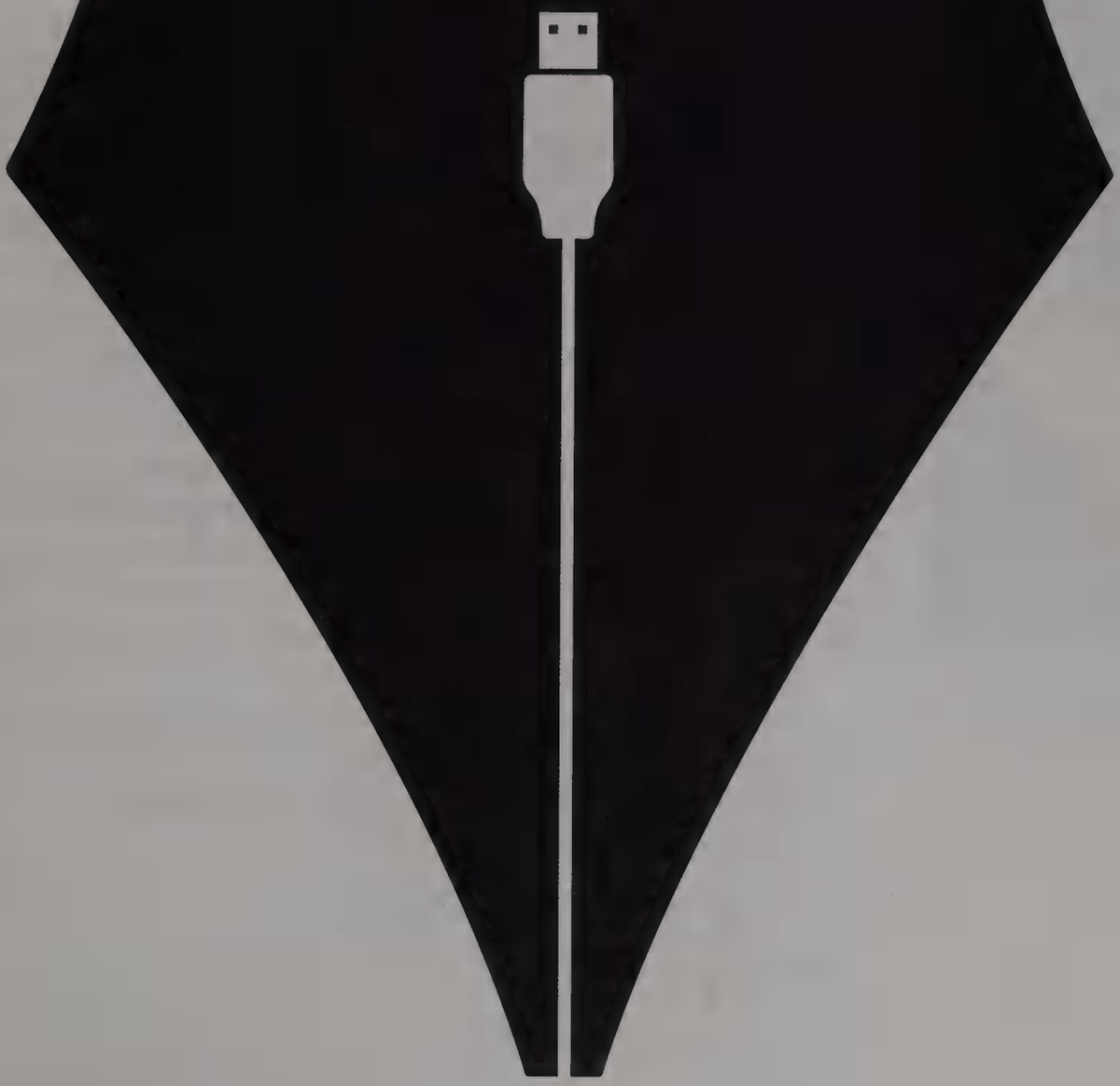
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From the Editor

HBR Predicts the Future

I recently came across a remarkable article in the dusty bound volumes of *Harvard Business Review*'s archives. In a department called Thinking Ahead, "Next Revolution in Retailing" forecast the rise of electronic commerce way back in 1967, nearly three decades before Jeff Bezos launched Amazon.com.

The authors, a pair of Ohio State marketing professors, didn't have the vocabulary we use today—PCs, clicks, e-anything. But they were impressively prescient about how people would want to buy in the coming years.

"In the not too distant future a substantial share of [staple] items may be marketed through...large central distribution facilities," the professors, Alton Doody and William Davidson, wrote. "Consumers will never set foot inside these centers....Instead, retail transactions will be made by electronic telecommunications and push-button devices installed in private homes and hooked on-line to data processing networks."

Indeed.

HBR even tried to illustrate what this far-out system might look like. The drawing, reproduced on this page, shows a woman entering data on a blocky keypad with a terminal positioned above it. Not precisely a computer and screen, but close.

In late February I tried to get in touch with Doody; a former colleague of his, Mark Eisen, had informed me that Doody was seriously ill. Sadly, I wasn't able to reach him. He succumbed to cancer in early March in Columbus, Ohio.

But I was inspired by Doody's foresight, and so I'm asking our readers whether they have come across HBR articles over the years that accurately pointed the way forward. (Or, for that matter, boldly predicted a future that never arrived.) When I made a similar request on our website some weeks back, one energetic reader, V.P. Kochikar, quickly came up with more than a dozen examples, ranging from a 2005 exhortation to business schools to become more practice oriented to our (unfortunate) praise of Enron as a model for all to emulate.

I particularly liked this prognostication from a 1957 piece on the future of supermarkets: "As the number of women employed increases....Higher incomes and more leisure time will encourage dining out....Moreover, the continuing decline in domestic servants...will make dining out more appealing."

HBR has always viewed business from a variety of angles.

I'd love to hear from more of you.



ABOVE
Illustration from "Next Revolution in Retailing," by Alton Doody and William Davidson, HBR May–June 1967

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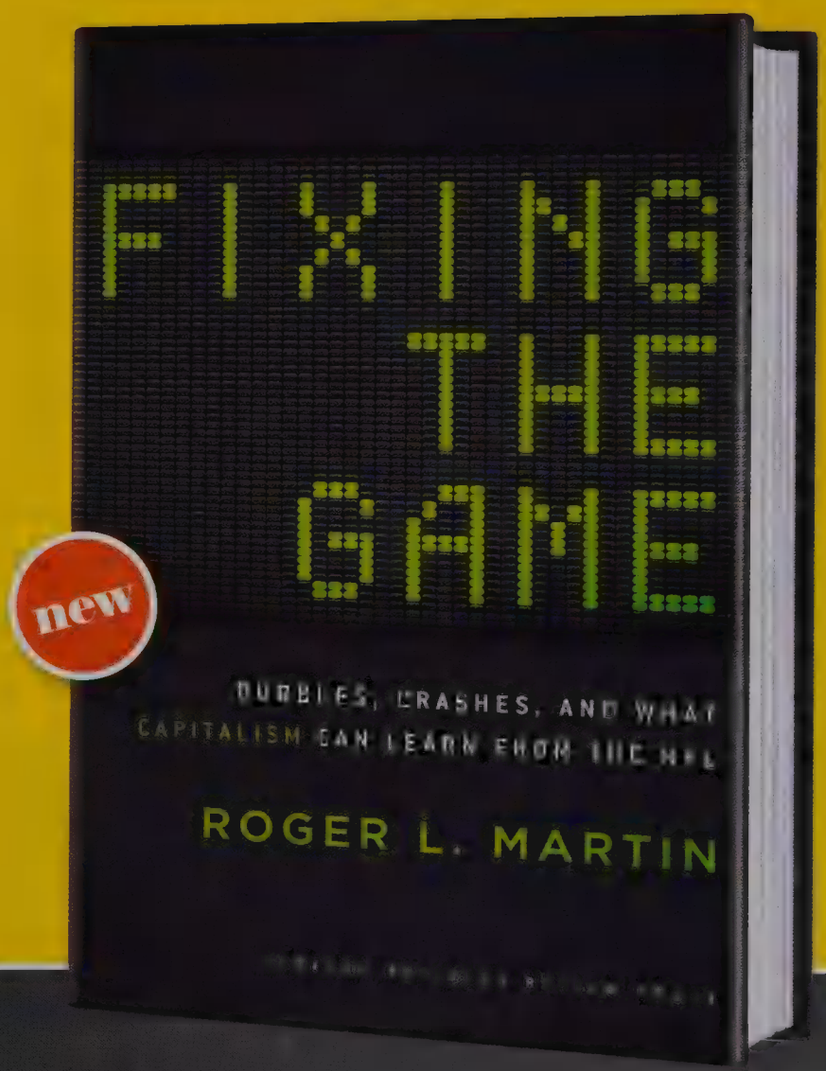
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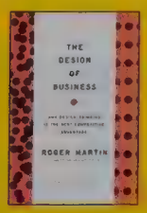
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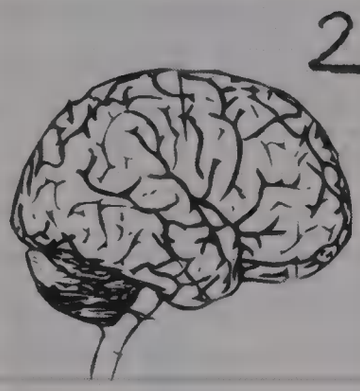


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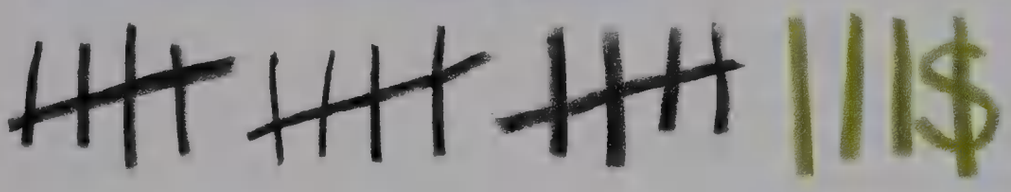
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Capitalism for The Long Term

HBR article by **Dominic Barton,** March 2011

The financial crisis may have passed, but the foundations of capitalism are still shaky, says Dominic Barton, McKinsey & Company's global managing director. He argues that corporate leaders must not return to business as usual. If they don't reform their companies by jettisoning short-term goals, putting stakeholders at the center of strategy, and "bolstering boards' ability to govern like owners"—they will watch as governments exert control.



The Anglo-American model of capitalism is due for an enormous shakeout. We should look at the European model (seen in the Scandinavian countries, Germany, France, and the Netherlands), where the strength of society is maintained through a degree of social mobility based on merit, social cohesion, and social services that help smooth out the differences between those who have and those who have not.

Kenneth Armitage, former chairman, Committee 86B, International Electrotechnical Commission

The main value of capitalism is its competitive nature, which leads to innovation. But we also need a continuous growth of wealth, because the world's population continues to grow. If we don't have that, we will all get even poorer.

Elizabeth Forbes, corporate governance consultant

The idea that growth can be infinitely sustainable is the mathematical and physical impossibility upon which our entire economic system is based. Nature has no system that can support this kind of growth; the closest example to something that *can* is cancer. Unfortunately, once the host has been devoured, the cancer is also destined to perish.

Richard Chrenko, senior adviser, The Natural Step Italy

The author gently reminds companies of their responsibilities and tries to persuade them to do what is right. This is another way of saying that companies should continue to have the freedom to choose between being good and being bad. And to claim that tough regulations would stifle entrepreneurship is to argue that entrepreneurial companies thrive only in sleazy environments. If that is true, then capitalism deserves to perish.

Shivakumar Kunapuli, corporate adviser

I don't see anything in the economic or regulatory landscape that will entice business leaders to change. The same incentives that are motivating the current behavior remain in place—even after the recent financial meltdown. What we need is a new system of incentives (laws and regulations) that promote long-term thinking.

David Salahi, software developer, Kelley Blue Book

Mr. Barton offers readers a somewhat glib survey of threats to capitalism. We learn about the tyranny of short-term objectives, the failure to invite more stakeholders

The Short Life of Online Sales Leads

HBR article by **James B. Oldroyd, Kristina McElheran,** and **David Elkington,** March 2011

New research finds that more firms are waiting too long to respond to customer inquiries—or not responding at all.

Most companies have some form of lead qualification to ensure their limited resources are directed to the leads that are most likely to be profitable. In your web-generated lead test, the companies that responded to you almost immediately probably did so because their lead qualification filter gave you a high rank, whereas you didn't seem like a viable lead to pursue to the companies that did not respond to you as fast. Companies need to have better filters in place (beyond simple revenue and volume measures) to quickly determine what qualifies as a good lead. Also, the companies that responded in the first five minutes most likely sent you a standard response. In my view there is nothing worse than receiving a generic response to your query. The best salespeople tailor their response to the individual customer, and that is something you cannot do in five minutes.

Mashhood Beg, research analyst, Sales Executive Council, Corporate Executive Board

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to the banquet, and cultural impedance caused by pluralistic ownership. But there are many threats he doesn't mention, including the damage wrought by outsourcing strategy to white-glove consulting firms. Is it going too far to postulate that consultants are handmaidens to the very practices that threaten to undermine capitalism in the 21st century?
Robert S. Becker, president, Becker Multimedia

The same incentives that are motivating the current behavior remain in place.

The irony is that long-term success requires less effort and stress than short-term success. If you plant a garden in the spring and tend it through the summer, you will usually get a nice harvest in the fall. You can try to "rush" the fruit, but it takes a lot of effort and input, and the marginal reward is low for the time and money you could have spent more productively elsewhere. Long-term success is less about hard work and stress and more about focus, planning, and patience.
David Kaiser, CEO, Dark Matter Consulting

Barton offers a very good message and a call to action, but his article lacks specifics and is more than a decade late. The crisis is not at all over—indeed, we are still very much on the fence in the U.S., and it could go either way. And as we've seen recently in the Middle East, power ultimately rests with the people.
Mark Montgomery, founder & CEO, Kyield

We are in the midst of a revolution in the concept of money.
Martin Cawthorne-Nugent, independent business consultant

"One that would have the fruit must climb the tree."

—THOMAS FULLER



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Tools for Effective Communication

HBR blog series, February–March 2011

What's the best way to talk to reporters? How can you make your e-mails more "forwardable"? On these and other topics, experts tackled the complexities of communicating at work. In response, our readers offered their own suggestions for improving public-speaking skills, running meetings effectively, dealing with the media, and more.

"Delivering the Speech of Your Life," by Dan Pallotta *"Memorize your speech.... [I]t stops being about getting the words right and starts being about getting the feeling right."*

Memorization—don't do it! It takes actors years of experience and lots of training to be able to memorize and sound present.
Connie Miller, communication and speech coach, Pivotal Presentations

Memorize, but don't be a slave to it. I have found that when I do memorize, I don't actually stick to the script—I improvise here and there, depending on the audience's reactions. When I don't memorize, I'm constantly fumbling.
Lisa Hansen, owner, Hansen Editing

"Hold Conversations, Not Meetings," by Tony Golsby-Smith *"A conversation is a creative process....It is a journey that takes people through the full range of thinking, not just a problem at hand."*

Many meeting leaders are not emotionally equipped to deal with a meandering conversation, because organizations overwhelmingly value control and linear thinking.
Barbara Lond, director, BL Consultants

Conversations can be as dull and pointless as meetings. The missing link is good facilitation, which ensures everyone is heard, tough topics are pursued, and genuine outcomes are achieved.
Paul McKey, managing consultant, IBM Australia—Strategy and Transformation

Meetings are an effective tool for inept people to look extremely busy.
Faheem Mohammed, managing director, Professional Alliance Network (Caribbean)

"Media Mistakes and How to Avoid Them," by Dorie Clark *The three biggest mistakes executives make when dealing with journalists are "not understanding their motives," "not preparing for the obvious," and "not knowing the difference between 'answering' and 'responding.'"*

The mistake I'd add: Speaking from the head instead of the heart. What seems safe to many leaders often appears cold and unfeeling to viewers.
Will Hurwitz, Harvard Business School, MBA class of 2010

"The Practical Art of Persuasion," by William Ellet *"[I]f you aren't sure of what you're trying to do, whom you're trying to persuade, and how you can use the persuasive resources available in the situation, the media won't matter."*

The treatment of persuasion as an end is outdated. If you want to get people to listen to you, your success will be determined by how you can help your audience accomplish *their* goals—not yours.
Clay Forsberg, collaborator, The BleedingEdge

Any effort that comes off as calculated or condescending will backfire. True willingness to see the target audience's point of view and to find common ground is critical to effective persuasion.
Jim Akin, principal, Strategic Storyteller

Experts Are More Persuasive When They're Less Certain

HBR Q&A with **Zakary Tormala,** March 2011

Do people actually mistrust confidence in experts? Professor Tormala's studies show that people find experts more compelling when they are less sure of their opinions.

People want honesty from their leaders, particularly in the current climate. The trouble is that many leaders are reluctant to appear uncertain.
Simon Hayward, managing partner, Cirrus

Prolonged economic hardship and the uncertainties expressed by leaders have left us more willing to accept what is uncertain than what appears to be certain. We are consumed by doubt, and being doubtful is a simple way of safeguarding ourselves from future disappointments.
Danglade St. Rose, manager and owner, DSR Enterprise

Will humility and CEOs' subtle use of an unexpected level of uncertainty in their communications lead to a new era of greater influence and authenticity for executives? Maybe. One of the key ingredients for increasing CEO influence is to tone down the standard confident rhetoric and replace it with more humble assessments of where a business stands and how it hopes to grow. Transparency and honesty go a long way in building trust.
Rosanna M. Fiske, chair and CEO, Public Relations Society of America

Once you are established as an expert, people value your ability to examine the nuance in a situation. I can think of many times when I was a sell-side analyst and—once I had established credibility—investors didn't want to hear just "buy" or "sell," they wanted to know my thought process.
Whitney Johnson, founding partner, Rose Park Advisors

The New Path to the C-Suite

HBR article by **Boris Groysberg, L. Kevin Kelly,** and **Bryan MacDonald,** March 2011

New research shows that in the C-suite, "functional expertise matters less than leadership skills and a strong grasp of business fundamentals." The HBR community chimed in on what could be causing this shift in the C-level skill set.



In the coming decade, Gen Y will enter the C-suite and boost the feminization of leadership. This is why soft power is increasingly a required skill for executives, and the chief executive style is changing to one that is inclusive and collaborative, where decision making will rely strongly on positioning, political savvy, conflict management, and trust.
Dianne Jacobs, founding principal, The Talent Advisors

As long as we continue to talk about leadership in terms of "feminine" or "masculine" traits, we will continue to have lower numbers of women in C-level roles. People-centric skills are as critical to good leadership as more process-centric skills.
Yvonne Lumley, founder and CEO, People-Factors

The authors respond: *Historically, being well-rounded wasn't always necessary for functional leaders, as they would often rely on their deep domain and technical skills to influence decision making. Nowadays, more and more emphasis is being placed on leaders who can employ varied characteristics to influence diverse stakeholder groups.*

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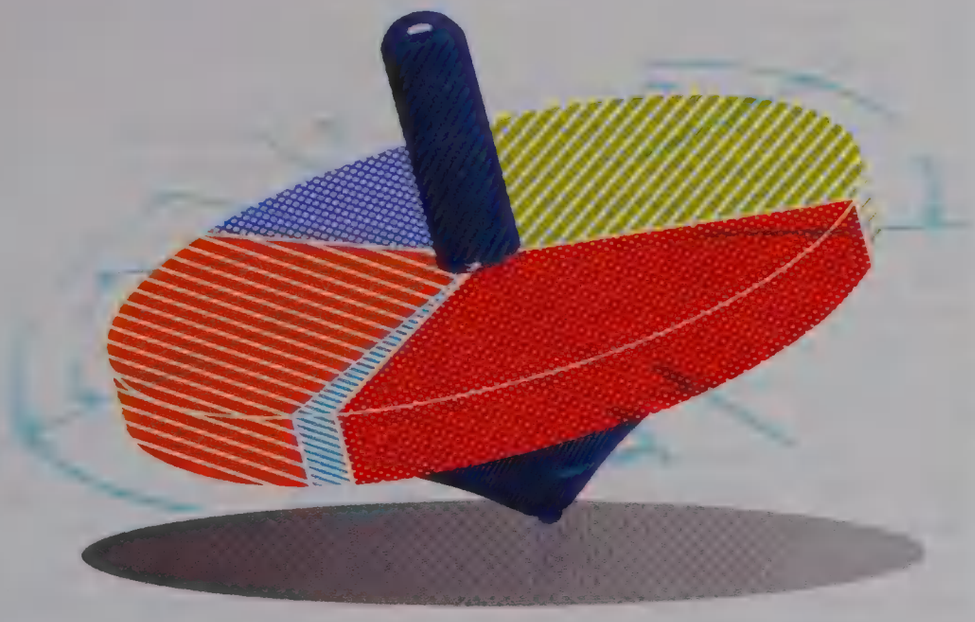
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FIRST

When Every Customer Is a New Customer

High-turnover markets offer big opportunities to win share. Here's how to do it. *by Karel Cool and Petros Paranikas*



When evaluating potential new businesses, one of the first questions managers ask is: How fast is the market growing? But managers who think only about growth rates may be missing real opportunities. Another factor can make even slow-growing markets highly dynamic: rapid turnover of the customer base.

Consider two markets that have seen little growth in recent years: smoking cessation aids and cigarettes. The market for the former has been flat for a decade, during which the shares of the leading brands, Nicorette and NicoDerm, were cut almost in half by Commit lozenges and other new products. Despite stagnant sales, the market was dynamic. Growth in the cigarette market was even negative at times, but the share of longtime leaders like Marlboro and Camel held steady. In this case the market was not dynamic. Why the difference?

Customers for cessation aids turn over quickly—either they kick the habit and no longer need to buy the product, or they soon revert to smoking. In this type of situation, customer loyalty is moot, so established market leaders are at risk. In the cigarette market, by contrast, most customers stay put, and the low turnover protects incumbents.

High customer turnover creates opportunities in fast-growing industries as well, and the upsets can be stunning. Video games provide a case in point. Nintendo's position seemed unassailable in the mid-1990s, but Sony ingeniously used the transition of teenage players into adulthood to hoist itself into the market. By 1996 its first gaming console, the PlayStation, had dethroned Nintendo and transformed the industry. The tables turned again a decade later, when Nintendo's Wii overtook PlayStation through a combination of innovative games, low pricing, and skillful targeting: Although Nintendo still aimed for young gamers, this time it included the emerging segment of family entertainment. More recently Sony and Microsoft have launched new, motion-based games that are challenging the Wii's dominance. These shifts demonstrate how dramatically a company's fortunes can rise or fall when the customer base—in this instance, young players and families—turns over quickly.

How Gerber Manages Turnover

Baby food is a classic high-turnover category, with newborns entering and toddlers exiting constantly. But Gerber maintains its 65% share and has grown sales by segmenting the market and moving customers from one stage to the next—and by keeping kids eating "baby food" long after they're babies.



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Entrees, such as chicken and carrot ravioli, that encourage the use of utensils



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Measuring Customer Turnover

Three factors drive high customer turnover. The first is infrequency of use by any one person. Products and businesses that have had a constant influx of new customers for this reason include funeral services, landscaping projects, pregnancy tests, real estate agencies, and moving companies.

The second factor is durability. We use cars and refrigerators all the time, but because they typically last for many years, we buy them only once in a while. People who purchase such products therefore *behave* like new customers; unlike consumers of toothpaste and other disposable products, they're not constantly in the market.

The third factor relates to how narrow the age range of the intended audience is: Products and services aimed at specific age groups have high customer turnover rates. Think of diapers, young-adult books and movies, bridal magazines, and retirement communities.

A good way to differentiate high-turnover from low-turnover markets is to calculate what we call the net turnover rate (NTR). To determine this rate, first assess the overall size of the market in the previous year. Then add the number of customers entering in the current year and subtract the number exiting. This gives you the total number of customers. Divide the number of new customers by the number of total customers to get the NTR. The higher the NTR, the greater the opportunity for new companies—and the greater the risk for established players.

Let's return to cigarettes and smoking cessation aids. In 2009, by conservative estimates, about 40 million people in the U.S. smoked. Each day some 3,000 to 4,000 start, for an annual total of roughly 1.3 million. Each year about 2.6 million quit. Thus the number of smokers in 2010 was 38.7 million, and the NTR was just 3.4%. The smoking-cessation-aid market, as discussed, is constantly renewing itself; its NTR is close to 100%. That's why new companies have been able to gain so much share.

NTR can vary widely by product category within an industry. For example, pharmaceutical companies would usually rather market drugs for chronic diseases (cardiovascular conditions, diabetes) than for acute ones (ear infections, influenza), because the turnover rate among patients with chronic diseases is much lower. And different kinds of customers within the same product category may have very different turnover rates. Whereas patients churn in and out of acute disease markets, their doctors typically prescribe the same meds for years. So although these patients have no reason to display customer loyalty, their doctors are likely to, which makes it harder for new companies. In general, the professional segments of a market have a lower customer turnover rate than the "occasional use" segments: Professors are a more stable segment than students, contractors are more stable than do-it-yourselfers, and so on.

Breaking into High-Turnover Markets

The fact that high-turnover customers don't have established loyalties doesn't necessarily mean they're easy game. The costs associated with pursuing them may be large, or they may be unusually risk averse. New competitors can exploit such conditions with the following strategies:

Any high-turnover industry has many more former than current customers. These "alumni" can be tapped to expand the customer base.

Cut customers' trial costs. Lowering the cost may persuade customers to give new products a chance. When Sony entered the video game console market, it had to woo consumers away from the well-known Nintendo and Sega systems. So it equipped the PlayStation with a CD drive, essentially making it the cheapest CD player on the market; even if the game system failed to take off, consumers still would have a CD player. The company adopted a similar tactic with PS2 (which doubles as a DVD player) and PS3 (which includes a Blu-ray player).

Offer a gateway to the competition. Entrants can also sway customers by providing a link from their product to an established competitor's. Apple's tagline and commercial "I'm a PC too" enticed many to try the new Macs, reassured by their ability to run familiar PC software.

Extend bundles to drive adoption. Apple has very shrewdly used its set of "i" products (iPod, iPhone, iPad) to take increasing command of markets once dominated by Sony, Nokia, and Amazon.

Leverage the reputation of low-turnover segments. Real estate agents operate in an extremely high turnover environment. They gain credibility by associating themselves with banks and insurance companies. Similarly, building-materials companies try to exploit their relationships with architects and designers to persuade the large number of contractors (and the even larger number of home owners) to adopt their products.

Maintaining Your Position in High-Turnover Markets

High-turnover markets are evergreen; they will always have new consumers. Once companies have established themselves in these markets, they need to defend their positions by decelerating market turnover while continuing to build a customer base. Here are some useful strategies:

Provide a migration path. When customers see that they can advance within the network of a product they've chosen, they're less inclined to leave. Systems like the airlines' silver/gold/platinum loyalty programs help retain customers. Lego gets toddlers started with Duplo blocks and offers increasingly sophisticated products for older children, thus keeping customers into their teenage years. Gerber adopted a similar tactic. (See "How Gerber Manages Turnover," at left.)

Increase platform value. Consumers are drawn to products that provide something extra rather than simply meeting the need that originally attracted them. Airline and credit card reward points dissuade many customers from shopping for better deals. Mobile phone "family and friends" packages keep them from switching providers. Facebook creates extra value—and stickiness—for regular and business members by enabling social commerce in addition to social networking.

Create and leverage "alumni" networks. Any high-turnover industry has many more former than current customers. They can be the best spokespeople for a product and valuable agents in expanding the customer base. Universities have long organized alumni events to grow and leverage the loyalty, support, and word-of-mouth of past students. Consulting companies generate many new assignments by tapping executives they once served who have since moved to different companies.

Customer turnover is a rip current that can sweep established players off their feet and create great opportunities for new competitors. But it's important to remember that as markets change, so do turnover rates; the opportunities ebb and flow. Most companies have a range of product lines, each with a different turnover velocity. They need to know where and when to decelerate turnover to defend their position or accelerate it to gain share. In markets where turnover is immutably fast, the battle for customers is never decisively won. However, the rewards for even temporary victors can be large indeed.

HBR Reprint F1105A

Karel Cool is a professor of strategy at Insead. **Petros Paranikas** is a partner and managing director at Boston Consulting Group.

Calculating Net Turnover Rate in the Market for MBA Programs

It's intuitive that the market for some products—bridal magazines, say—experiences high customer turnover. For other markets, quantifying the churn can help new competitors understand the opportunities. For example, the market for MBA programs may seem exceedingly stable, with the top-ranked programs having held their positions for decades. But beyond the elite schools, the market is surprisingly dynamic: In recent years applications to one-year programs and for-profit and online schools have increased significantly. The opportunity for new competitors can be seen clearly by calculating the NTR—the ratio of new students to total students. Using conservative estimates:

NUMBER OF U.S. MBA STUDENTS IN 2007–2008
240,000

NUMBER WHO GRADUATED IN 2008
100,000

NUMBER WHO ENTERED IN 2008
110,000

NUMBER OF U.S. MBA STUDENTS IN 2008–2009
250,000

NET TURNOVER RATE
(ENTRANTS DIVIDED BY TOTAL STUDENTS)

$$\frac{110{,}000}{250{,}000} = 44\%$$



ACURA

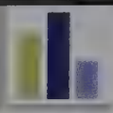
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Stat Watch



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62%

Multitasking 101

Fully 62% of the web windows that college students open on their laptops during class are completely unrelated to the class, according to a study by **James M. Kraushaar** and **David C. Novak**, of the University of Vermont. Unsurprisingly, the students who allocate their cognitive resources this way get lower grades than their more attentive peers. Instant messaging is an "especially virulent" distraction, the researchers say.

by Ryan W. Buell and Michael I. Norton

Think Customers Hate Waiting? Not So Fast...

How often have you found yourself staring at your computer screen as a progress bar tracks the machine's fitful loading of an application or completion of a search and wondered, "What's taking so long?" Good managers worry about wait time because a great deal of evidence (not to mention common sense) suggests that reducing it can increase customer satisfaction. Our research, however, demonstrates that a different approach—simply showing people what *is* taking so long—gets better results. Customers find waiting more tolerable when they can see the work being done on their behalf—and they tend to value the service more.

This holds true even when what's shown is merely the *appearance* of effort. What we term the labor illusion—a demonstration of effort, whether literal or not, expended to meet the customer's request—can be so effective, in fact, that many customers who endure waits but see a running tally of tasks end up happier than those who don't have to wait at all. People even prefer waiting with the labor illusion to playing an interactive game of tic-tac-toe.

In one experiment we conducted, participants searched on a simulated travel website for a flight. Some watched the typical boring progress bar. Others could see each airline being canvassed. The second service received higher ratings, even when those using it were forced to wait for as long as a minute. In another experiment, each participant booked the same trip through two different sites and received identical results. One site delivered the results instantly but invisibly, whereas the other took either 30 or 60 seconds but showed the labor being done. A majority preferred the transparent—and slower—site.

Can the labor illusion trump poor results? To find out, we created a fictitious online dating site and gave some participants good outcomes (extremely attractive "soul mates") and others disappointing ones (decidedly less appealing prospects). We found that people valued transparency only when their "matches" were at least decent looking; forcing them to wait and then delivering duds made them dislike the service even when they could track the matchmaking process. ("You went through all that work and found *him?*")

Many of us have already experienced the labor illusion online: The travel website Kayak, for example, shows customers each airline it searches. We'll increasingly encounter it in other environments as well. Apple recently augmented its automated voice response system with the prerecorded sound of typing, creating the impression that the digital operator is physically keying in the caller's query. ATMs at the Spanish bank BBVA show an animation of bills being counted as customers wait for the machines to spit out their cash. The U.S. Postal Service has installed screens that show customers each step being taken by the postal worker who is helping them. Starbucks now requires that baristas steam milk for each drink individually—a process that increases wait time but allows customers to see what's going on.

Transparency has long been heralded as a virtue in accounting and public relations. Our research suggests that operations can reap important bottom-line benefits from it as well.

HBR Reprint F1105B

Ryan W. Buell is a doctoral student and **Michael I. Norton** is an associate professor at Harvard Business School.



Microsoft

Now we're talking private cloud, not just virtualization.

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It's your private cloud. If you want to run different hypervisors and operating systems, that should be your choice to make — because the technology and vendors you use are there to serve your business needs, not the other way around.

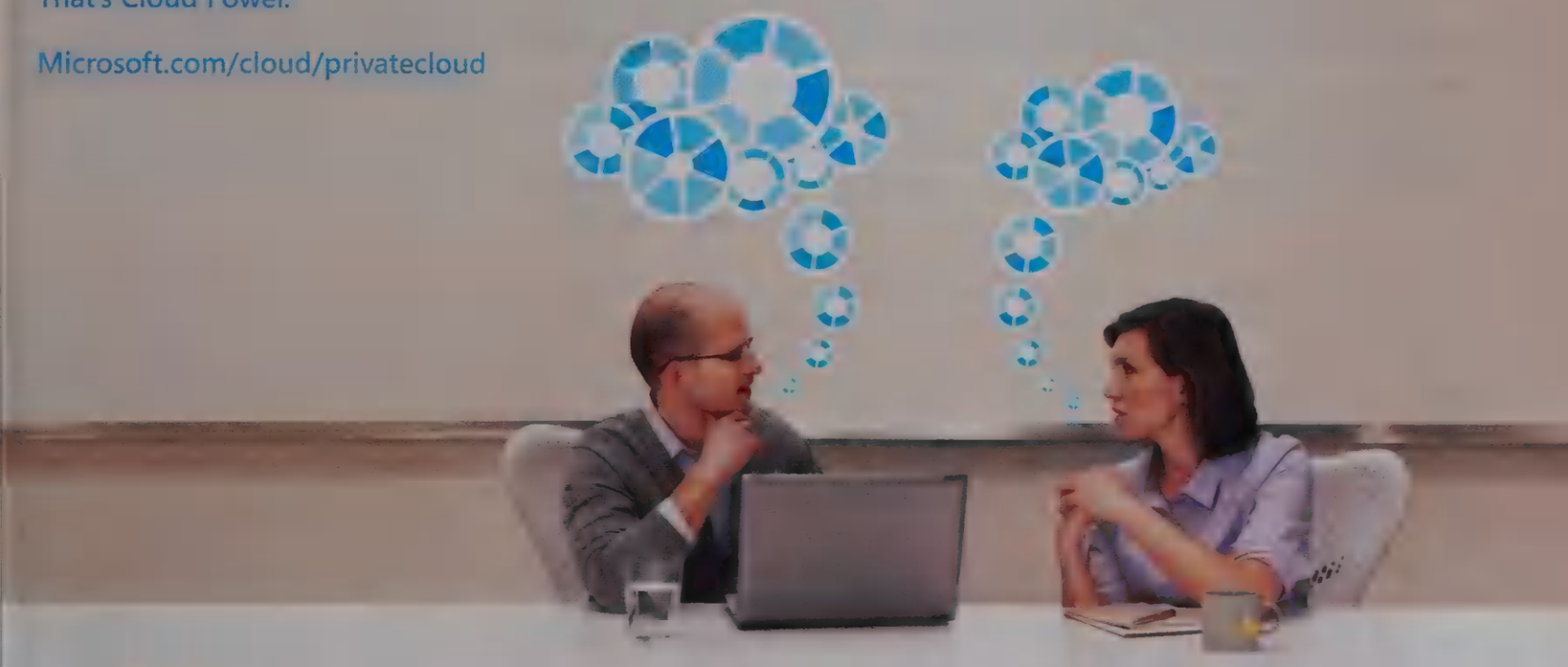
IT is no longer just about hardware. Or software. Or maintenance. It's about finding new efficiencies and new ways of doing things that help your company's bottom line.

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Microsoft.com/cloud/privatecloud



Cloud Power

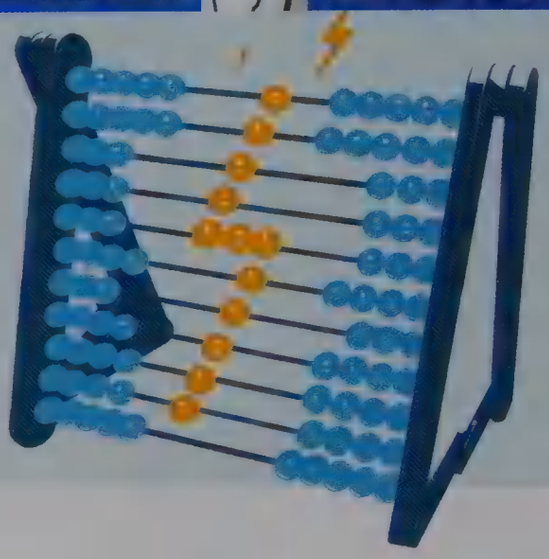
Windows Server Hyper-V

Research Watch

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A Shocking Way to Solve Problems

Research subjects who received electrical stimulation in the anterior temporal lobes of the brain were three times as likely as others to come up with the fresh insight needed to solve a difficult, unfamiliar math problem, according to **Richard Chi** and **Allan Snyder**, of the University of Sydney. The researchers envision a future when brief, noninvasive brain stimulation can be used to help people solve problems that have evaded traditional cognitive approaches.



MARKETING *by Marco Bertini, John Gourville, and Elie Ofek*

The Best Way to Name Your Product 2.0

When managers at the golf equipment company Callaway launched the successor to its Big Bertha driver, in 1995, they faced a challenge: What should they call it? They settled on Great Big Bertha, which was followed two years later by Biggest Big Bertha. It's a clever progression—but is it the right way to name next-generation products?

Although there's ample research to guide marketers in naming new products, little of it has addressed follow-on offerings, even though these make up the bulk of new products in industries ranging from automobiles to digital cameras.

Companies have two basic strategies to choose from. They can stick with a name, as Cadillac did during the 45-year run of its Coupe de Ville—often adding a sequential indicator, as Callaway did with its Berthas. We call this brand-name continuation. Or they can come up with a new name for the next version, as Nintendo did with its N64, GameCube, and Wii gaming platforms. We call this brand-name change.

Which strategy works best? It depends. In laboratory and field studies involving hundreds of subjects, we found that when consumers see a brand-name continuation, they expect improvements to existing features. When they see a brand-name change, they expect fundamentally new features, and they perceive the product as riskier (likelier to fail or more prone to compatibility problems with previous products) but potentially more rewarding (higher in quality, more satisfying to use). These findings suggest three questions that managers choosing next-generation names should explore:

> When customers see a brand-name change, they expect radically new features.

What is the target market's attitude toward risk and reward? Consumers' risk tolerance varies widely from one demographic to another. Young people typically accept risk in exchange for greater reward; for example, they often prefer an entirely new video game despite the higher likelihood of glitches. The Wii was Nintendo's fifth home video game console; its name change signaled a dramatic departure from previous generations. Microsoft Office caters to business users who care more about consistency than novelty, so it uses brand-name continuation to highlight its reliability.

What are the consequences if things go wrong? Consumers' perceptions of risk depend in part on the setting. Error is less acceptable in business and social contexts than in private. Whereas Honda wisely stuck with Accord for each iteration of its family sedan, Gillette gave new razors their own names (Sensor, Fusion). In addition, the possibility of error is more easily tolerated when backups are available. In one lab experiment we conducted, subjects asked to select a new camera for a vacation typically chose a next-generation model with a new name when a family member would also be taking a camera; otherwise they opted for a (presumably) more reliable same-name camera.

What is the competitive landscape? Your relative strength in the market also matters. In the mid- to late 1990s, AMD's K5 and K6 microprocessors trailed Intel's Pentium series in sales. So in 1999 AMD gave a new name, Athlon, to its next-generation processor, which did much better in the marketplace than its predecessors had.

Names set expectations. Above all, make sure your product delivers on them. Because it had a new name, Microsoft's Vista operating system primed consumers to expect dramatically new capabilities that the software did not actually have. The company thus mismanaged expectations. Callaway's brand-name continuation pointed to steady but not radical improvements—a perfect message for golfers, who don't want surprises to ruin their games.

HBR Reprint F1105C

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Defend Your Research

HBR puts some surprising findings to the test





Tsedal Neeley (tneeley@hbs.edu) is an assistant professor in the organizational behavior unit at Harvard Business School.

Paul Leonardi (leonardi@northwestern.edu) is the Allen K. and Johnnie Cordell Breed Junior Professor of Design at Northwestern University.

Effective Managers Say the Same Thing Twice (or More)



CONNECT WITH THE AUTHORS Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

The finding: To get employees to do something, managers need to ask them at least twice.

The research: A team led by professors Neeley and Leonardi shadowed 13 managers in six companies for more than 250 hours, recording every communication the managers sent and received. The researchers discovered that one of every seven communications by the managers was completely redundant with a previous communication using a different technology. They also saw that the managers who were deliberately redundant moved their projects forward faster and more smoothly.

The challenge: If we communicate clearly, do we really still have to repeat ourselves? Isn't that inefficient? **Professors Neeley and Leonardi, defend your research.**

Neeley: We know that the effective managers repeated themselves at least once, and we often observed managers who sent three or four redundant communications. We saw some clear patterns with regard to who did this and how. For example, we divided our managers into two types: those with formal power and those without it. We found that those without power planned their redundant communications and that frequently very little time passed between their first message and their second.

HBR: They actually intended to say the same thing twice from the outset?

Leonardi: It was very deliberate. One manager we observed worked on an e-mail for 20 minutes right after explaining his request to the employee in a conversation. He not only was aware of the redundancy but took the time to make sure the two communications said the same thing.

Neeley: Managers with power, however, were redundant in a more reactive way. We found that they think they can tell people what to do just once, but the lack of an adequate response forces them to send a redundant message.

Were both approaches equally effective?

Neeley: Managers without power who were deliberately redundant moved the needle faster. The managers with power got as much done, but it took them longer, and they spent more time doing damage control or in crisis mode because they'd assumed their requests were being fulfilled before realizing they needed to follow up.

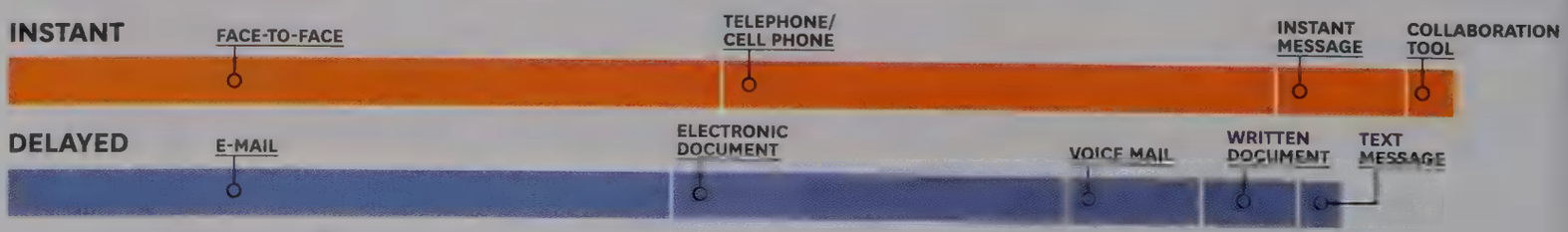
Leonardi: We don't have data showing that one group outperformed the other on meeting project deadlines or budgets. But we saw a difference in how employees responded to the two groups when it came to liking and respecting managers versus getting annoyed by them. People had more esteem for managers without power.

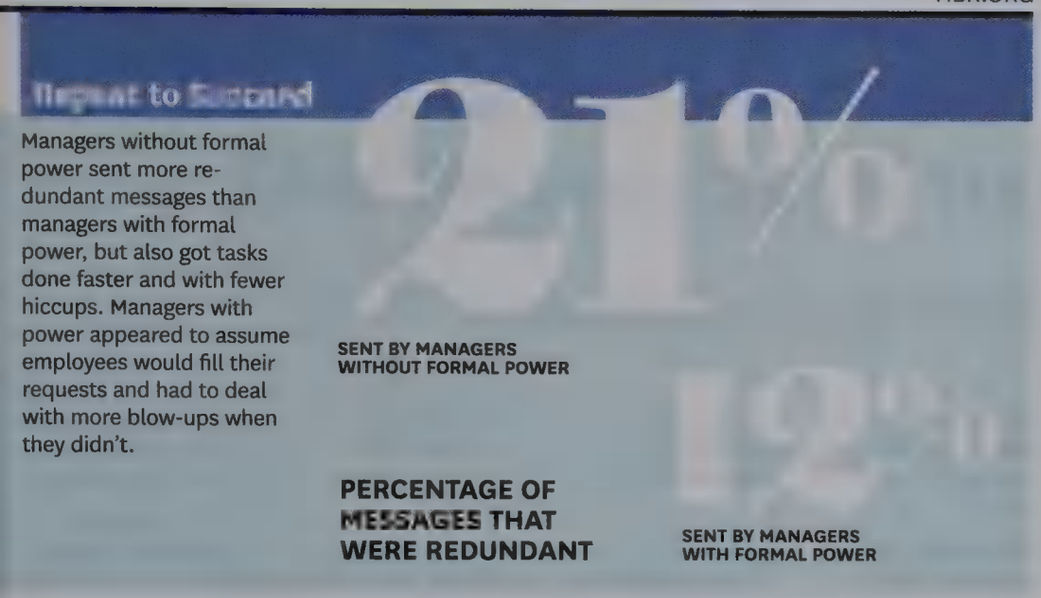
Does technology play a role in all this? It's so easy to bombard people with messages now.

Neeley: Only partly. What's equally important is that the nature of work has changed. We've moved toward project-based teams. We form them, work, disband, form new

THE MEDIUM OF THE MESSAGES

Face-to-face meetings and e-mail were the most popular forms of communication used by managers.





teams, and so on. You end up with team leaders without much management experience and also less trust in those leaders. The social and organizational dynamics are such that you can't just tell people what to do anymore. They may not work for you.

Leonardi: We're so bred to believe that clarity is the key to being a better communicator. The literature says pick the best medium for the job, and anything else is wasteful. This research suggests that's not true. You need to use multiple media. It's not necessarily just about clarity. It's about making your presence felt. Employees are getting pulled in many directions and reporting to lots of people and getting tons of communications. So how do you keep your issues top of mind? Redundancy is a way to do that.

Managers complain about information overload all the time. Now we find out they're creating it by being redundant!

Neeley: All the technologies available—phone, e-mail, instant message, shared folders, WebEx—increase the frequency of communication. Redundancy helps your message get through lots of messages. Gives it more weight. I also believe managers have started strategizing on how to be redundant. Those in our research also seemed to be selecting different media pairings to achieve different goals.

What patterns did you see?

Leonardi: Managers with authority started with a delayed communication—one that may not be received right away, like an e-mail or voice mail. When things didn't get done, they'd shoot off an instant communication. Managers without power did the opposite. They started with an instant communication, often a face-to-face conversation, and then followed up with a delayed message. Think about it: Managers with power assume their authority motivates others. Managers without it need to get buy-in, so their first message is for motivation. The follow-up is to document something, remind people they've made a commitment so that it doesn't fall off their radar.

Neeley: We noted a qualitative difference in the content of the messages, too. As you might expect, managers without authority did not use directive messages as much. They used persuasion more.

Were managers surprised to hear that they were being redundant?

Leonardi: If anything, they would look at us as if to say, "Seriously, you think this is interesting? This is how it works. Of course I follow up with another message."

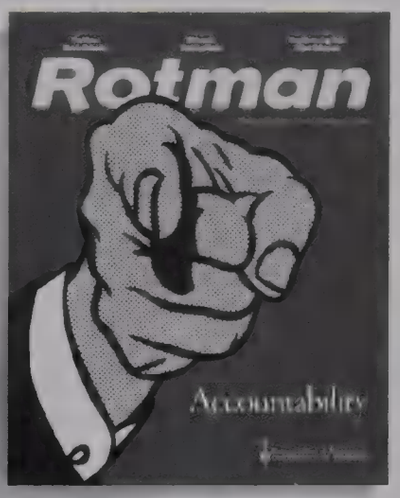
Tell me what's next in redundant communication research.

Leonardi: Fatigue is an interesting question. Is there a redundancy threshold? Will people eventually say, "Enough—stop communicating with me"?

Tell me what's next in redundant communication research.

Neeley: [Laughs] The other thing that would be fascinating is to see how this behavior spreads. Are the employees who receive the repeat messages picking up those norms? Do they do it at work? In their personal lives? And going forward, what will that mean?

HBR Reprint F1105D



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Vision Statement

Geoff Tuff (gtuff@monitor.com) is a partner at Monitor Group. **Open** is a design studio in New York.

How Hot Is Your Next Innovation?

Data by **Geoff Tuff;** visualization by **Open**

Choosing which innovative ideas to pursue is often an exercise in guesswork. But by using existing management tools in a new way, you can effectively gauge your innovation's potential along two crucial dimensions: Can it withstand market pressures from competitors? And can it deliver more economic value to customers than alternatives? Here's how it works.

Doblin's Ten Types of Innovation

Finance

① **BUSINESS MODEL** How the enterprise makes money

② **NETWORKING** How your value chain and partners make your offering distinctive

Process

③ **ENABLING PROCESS** Assembled capabilities you typically buy from others

④ **CORE PROCESS** Proprietary processes that add value

Offering

⑤ **PRODUCT PERFORMANCE** Features and functionality

⑥ **PRODUCT SYSTEM** Extended system surrounding an offering

⑦ **SERVICE** How you service customers

Delivery

⑧ **CHANNEL** How you connect customers to your offering

⑨ **CUSTOMER EXPERIENCE** How you create an integrated experience

⑩ **BRAND** How you express your value to customers

First, take your idea's ambient temperature.

To find out if your idea is hot enough, consider how it is kindled. Each flame represents one of the Ten Types of Innovation, developed by Doblin (a part of Monitor Group) on the basis of research with hundreds of companies. The more ways in which your idea is innovative, the better able it is to stand up to competitors' offerings.

According to our research, ideas that innovate in six or more areas are well positioned for success. Fewer than three types and your idea is cold: Chances are, it's not distinct enough from products already on the market.

Most companies focus their innovations on product offerings, but you'll get more heat from ideas that also innovate new business models and customer experiences.

Next, measure your idea's heat index.

So your idea is hot, but will it deliver measurable value to customers? Doblin and Monitor have developed a simplified version of the pricing tool Economic Value Estimation (EVE) to calculate, by innovation type, how much increased value your idea offers over what's already available. Interpreting the EVE factor depends on the industry. A hot number in a B2B business could be as low as 1.5, whereas in a CPG context, where brand matters so much, the number will most likely need to be much higher, say 3 to 5. Anything below 1.1 would be cold, and anything less than 0.75 would be a nonstarter.



Incremental Economic Value
(The sum of the increased revenue or decreased costs associated with each innovation type)

Reference Value
(What customers pay for the next-best alternative)

IEV ÷ RV = EVE factor

GenetiCorp's New DNA Testing Kit

In this fictionalization of a real case, GenetiCorp's idea is DynaTest, a product that enhances DNA analysis by increasing the yield of each sample collected and by preserving the integrity of samples much longer than its primary competitor, EnSyn, can. DynaTest innovates in just four categories—a tepid idea. But when GenetiCorp tested its product with customers, it discovered a robust EVE ratio of more than 2. The high EVE brings this idea from tepid to warm.

To get it hot, GenetiCorp should find ways to wrap more types of innovation around the core DynaTest offering, even if they don't add much incremental economic value (there's enough already). For example, DynaTest could innovate in customer experience by creating an online community for lab techs to share best practices. It could also innovate in networking by partnering with a software company that sells products used for DNA analysis.

③

Enabling Process

Because DynaTest allows customers to get more yield from each sample, laboratory staff work is reduced. Customers save two hours of processing labor compared with the reference value product, EnSyn. Laboratory personnel earn $24 per hour.

Labor Savings: $48

⑤

Product Performance

Emergency sample collections require researchers to repeat the entire analytical test—an extra 16 hours of labor at the $24-per-hour rate. That's $384. DynaTest reduces emergency collections by 10%.

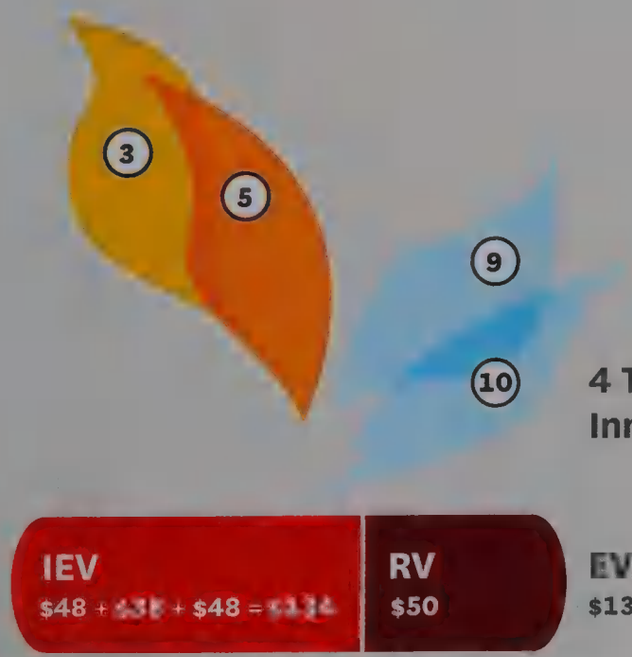
Labor Savings: $38

⑨⑩

Customer Experience And Brand

DynaTest's proven ability to maintain uniform quality was lauded in interviews with customers. Trust in its performance allows researchers to eliminate two hours of quality-control work at the $24-per-hour rate.

Labor Savings: $48



4 Types of Innovation

IEV	RV
$48 + $38 + $48 = $134	$50

EVE factor
$134 ÷ $50 = 2.68

NOTE THIS EXAMPLE WAS ADAPTED FROM *THE STRATEGY AND TACTICS OF PRICING*, BY THOMAS T. NAGLE, JOHN E. HOGAN, AND JOSEPH ZALE.

The Heat Behind Some Other Ideas

Cold: Microsoft Zune



product performance
experience

Microsoft's portable music player, Zune, innovated in product performance with built-in wireless and in customer experience with song and photo sharing. But innovating along two dimensions was not nearly enough to allow it to withstand the market pressure of its primary competitor, Apple's iPod.

Warm: Groupon



business model
core process
product performance
channel
customer experience

Groupon's innovations include its business model—forcing scarcity on good deals by imposing a time limit. It created a new channel between shoppers and merchants. It invested in customer experience, customizing offers regionally and employing a creative team to write witty e-mails to patrons. Its core process allows businesses to make up for the discounts through higher volume. Groupon's EVE is high now, but because the idea innovates along only five dimensions, it's not clear how long Groupon can sustain its advantage.

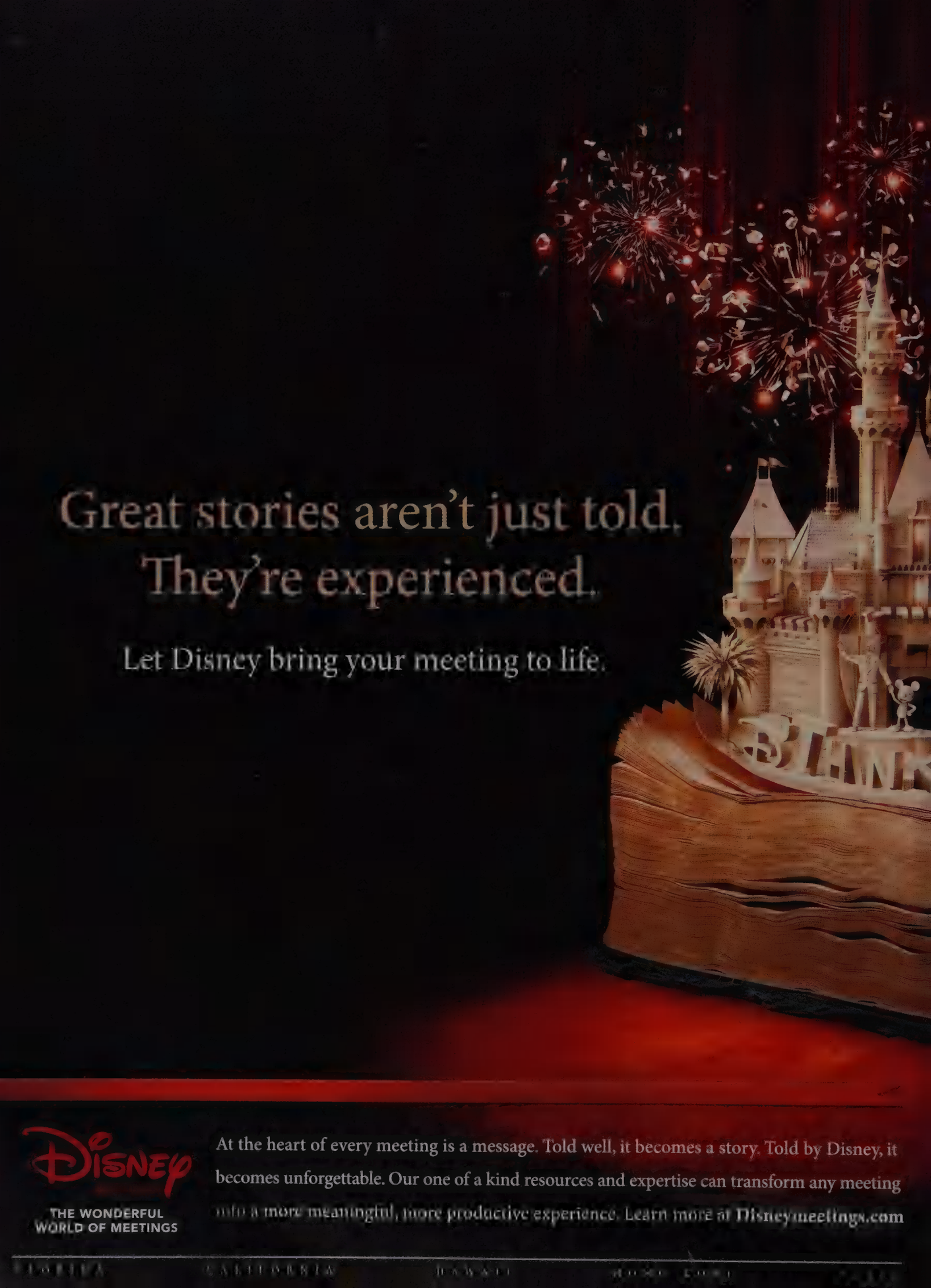
Hot: The Grateful Dead



business model
enabling process
product system
service
channel, customer
brand

The Grateful Dead was an innovation machine. Its business model was based on concert revenue, not record sales; it had a direct-to-consumer sales channel; its customer experience was unique. In addition, the product system was buoyed by bootleg recordings; its enabling process allowed merchants to become business partners; and pre-internet mailings announcing concert dates showed customer service innovation. Though it's doubtful that the Grateful Dead knew or cared about EVE, it's safe to say that the band's members were higher than anyone else in the industry.

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CAPTION CONTEST



"That's it. Accounting and Marketing go back to decaf."

This month's winning caption was submitted by **Kevin J. Rogers** of Clifton Park, New York.



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Kaplan



Robert S. Kaplan is the Baker Foundation Professor at Harvard Business School.

The Hollow Science



In the aftermath of the financial meltdown, it's become clear that the executives of many major financial institutions operated with inadequate and distorted information about the value and risks of their firms' assets. As a result, they failed to anticipate the crisis and reacted slowly and ineffectively when it hit.

Perverse incentives, insufficient governance, and weak regulation clearly contributed. But after decades of management research and education, it's fair to say that business scholars bear some responsibility as well. We have largely failed to produce a body of knowledge that would have helped companies value and manage risky financial assets.

How did this happen? The problem was neatly described 15 years ago by the economist Paul Krugman in a provocative essay that compared research trends in development economics to the evolution of the mapping of Africa:

> The coastline...was first explored, then plotted with growing accuracy, and by the eighteenth century that coastline was shown in a manner essentially indistinguishable from that of modern maps.... On the other hand, the interior [had] emptied out. The weird mythical creatures were gone, but so were the real cities and rivers. In a way, Europeans had become more ignorant about Africa than they had been before....improvement in the art of mapmaking raised the standard for what was considered valid data....Only features of the landscape that had been visited by reliable informants equipped with sextants and compasses now qualified.

Business scholars bear some responsibility for the financial meltdown.

Krugman could have been writing about my own discipline. For the past 40 years, most research in accounting and finance has focused on the coastline of business—the capital markets where companies and investors meet. Academics have applied ever more sophisticated analysis to the associations between the prices of traded equities, debt, and financial instruments and the information in company disclosures, corporate governance practices, and financial analysts' reports.

But like the 19th century African cartographers, we actually know less about what happens inside companies than we did 40 years ago. Most of us are neither studying nor teaching the emerging best practices in asset valuation and risk management in well-managed financial institutions. (A few of these do exist and are worth learning from.) I know of one major bank that does not hire U.S. business school graduates because they don't have the requisite skills to value and assess the risks of complex, infrequently traded assets.

To remedy this knowledge gap, more business school scholars, particularly in accounting, need to shift away from coastline studies, conducted on computer terminals in their offices, and begin to explore the interior of leading-edge company practices. A detailed, qualitative case study that documented and analyzed how innovative managers value and manage risky assets would be far more informative than yet another study of the correlation between public accounting data and average stock market returns. Careful clinical and descriptive research gets done by scholars in other professions, such as medicine and engineering, where practice innovation and small-sample research coexist comfortably and collaboratively with the randomized experimental trials and epidemiological research that test emerging practices in large samples.

Some opportunities arise just from breaking down silos around academic disciplines. Accounting scholars, standard setters, and regulators have been slow to apply the options pricing models created by financial economists in the 1970s as tools for measuring and disclosing the risks of many company assets, including pension plans. That's surely misguided. What if physics professors in 1945 had taught and done research using only Newtonian mechanics, ignoring the breakthroughs from the discovery, 40 years earlier, of quantum theory?

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Ariely



Dan Ariely (dandan@duke.edu) is the James B. Duke Professor of Psychology and Behavioral Economics at Duke University and the author of *The Upside of Irrationality* (HarperCollins, 2010).

The Upside of Useless Stuff

There's been plenty of talk lately—in these pages and elsewhere—about a new kind of capitalism. About creating things because they're good for society. About understanding, as Michael Porter and Mark Kramer suggest ("Creating Shared Value," HBR January–February 2011), that not all profits are created equal: Profits derived from making the world better are superior to those derived from the consumption of useless, or even harmful, junk.

At the risk of touching the third rail, I propose that getting people to want things they don't really need may be far more valuable to society than we think.

Imagine that I started a business selling beautiful bottles of air for $10. I'd call them Respirer (ress-pire-AY—it's French!). My advertisements would laud Respirer's purity, evoking bracing mountain air. *(Fewer than 10 parts per trillion of particulate in every bottle!)* Celebrities would endorse Respirer's rejuvenating effects. *(Kate Winslet starts every day with Respirer!)* In a matter of months, department stores would be selling out, and spas would brag that their saunas piped in pure Respirer air.

Respirer would be a runaway hit. Of course, it would be just air, and in most places you could get all the reasonably high-quality air you wanted free. So how could this clearly useless product have a beneficial effect on the economy? It would motivate people. By hyping Respirer, I'd give consumers something to want, and in order to be able to afford it, they'd have to work—to be productive.

As we continue to redefine capitalism, let's not discount the role of aspiration and the desire for luxuries in fueling productivity.



We often talk about how marketing's job is to get us to want things and spend our money, sometimes foolishly. But that reflects only marketing's output. Marketing also creates input: It spurs us to work to earn the money to buy the things we want.

Consider for a moment a world without marketing hype. One in which there's nothing you really desire beyond what you need to live. There's nothing your kids want; they don't bug you every time you're in the supermarket. How hard would you work in such a world? What would motivate you to work harder?

Now consider our current consumer environment: Multiply the desire for Respirer by thousands of products of varying levels of utility: iPads, leather couches, crystal martini glasses, cars, garden gnomes. It's like having thousands of little motivational speakers hovering around us.

Suppose I'm a surgeon. Could it be that my desire for Respirer, and all this other stuff, would spur me to work harder? To innovate new procedures that would save lives and also enrich me personally? I suspect it's very likely.

Let's be clear. I don't mean to say that marketing will save our economy. Or that marketing things we don't need is the key to a prosperous planet. The line is narrow indeed between being motivated to work and mortgaging the future—both your own and society's—to get stuff like bottled air.

Still, as we continue to redefine capitalism, let's not discount the role of aspiration and the desire for incremental luxuries—things we want and don't necessarily need. They can fuel productivity and thus have a valuable function in our economy.

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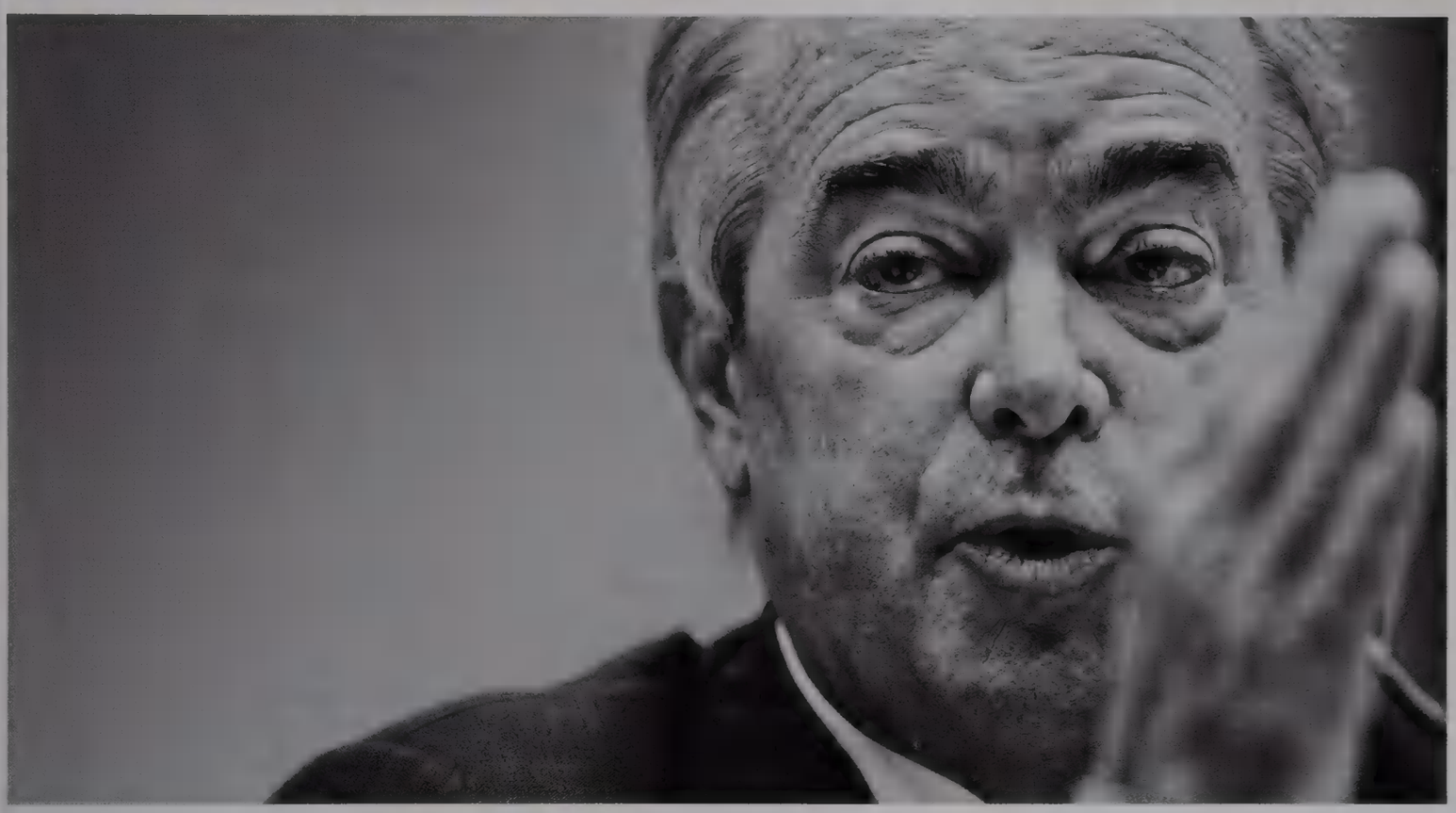


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How I Did It...

James E. Rogers is the chairman, president, and CEO of Duke Energy.

The CEO of Duke Energy On Learning to Work with Green Activists



by James E. Rogers

THE IDEA

When James Rogers became CEO at then-ailing PSI (now Duke Energy), he was determined to listen to all its stakeholders. But environmentalists posed a particular challenge: The green movement had long viewed the energy industry with skepticism.

"How can you advocate for a low-carbon future when your company is among the largest emitters of carbon dioxide in the United States?"

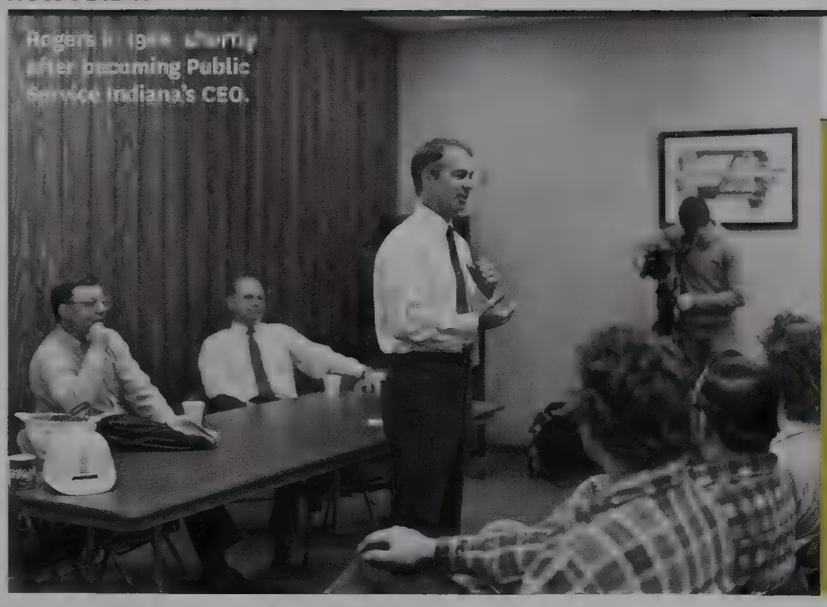
I'm asked this question a lot. It reminds me of a time about two decades ago, when I was 42 and in my second year as a CEO, trying to lead a utility back from the brink of bankruptcy. The effects of acid rain from burning coal had become clear. Much of our industry denied the facts and resisted any regulation of sulfur dioxide emissions. My company took a different path.

I believe that a price on carbon is inevitable, and utilities that take a long-term view will be part of the solution. Smart public policy can serve the interests of both business and society. It pays to be collaborative and build a consensus. But that isn't easy.

100 Days of Listening

I wasn't sure I had what it took to be a CEO when, in 1988, I interviewed for the job of leading Public Service Indiana, which had just written down a $2.7 billion loss on a half-constructed nuclear plant. PSI generated most of its electricity by burning coal in a number of aging plants in America's heartland.

At the time, I didn't consider myself an environmentalist. I was a lawyer with a background in energy, and I was looking


Rogers in 1996, shortly after becoming Public Service Indiana's CEO.

Beginning with "100 days of listening" gave me time to learn the business and the personal dynamics.

for something with greater challenges and more responsibility. PSI, once a highly regarded utility with deep local ties, had plenty of challenges: Its finances were in disarray, morale was damaged, and leadership had lost the confidence of regulators, shareholders, and customers.

I spent a week preparing for my job interview with PSI's board of directors and developed a plan I called "100 days of listening." The idea was to meet with the company's many stakeholders before taking action. That would help me to identify the issues, set priorities, figure out whom I could trust, and start repairing and rebuilding relationships. The other candidates had far more industry and leadership experience, but none of them came prepared with a plan. I was given the job.

All the members of my management team were much older than I was, and all of them advised me not to meet with any environmentalists. It was an emotional time for PSI's veteran executives; their largest construction project had just been killed by the very groups I was planning to talk to. Internal opposition to my proposal was so strong that I considered changing course. But that felt like a cop-out: I had proposed a plan, and now I needed to execute it. Plus I was curious about the environmentalists' point of view, and I believed in the power of collaboration to address tough problems. I decided to follow my instincts.

My management team was not pleased. Some of its members thought I was naive. Had PSI not been on the verge of bankruptcy, its dividend suspended and emergency rates in effect, I might have faced a mutiny during my second week on the job. On a Saturday morning I drove 100 miles south to the Ohio River Valley, where our abandoned nuclear plant was located. There I sat down for coffee in a diner with leaders from the environmental groups that had blocked the plant. I started by telling them I was new to the job and wanted to better understand their point of view. Soon enough they were talking straight about their perspectives, as midwesterners tend to do.

I learned that their opposition was based on three beliefs: Nuclear energy was too costly, waste disposal was unmanageable, and the additional 2,360 megawatts of baseload generation capacity wasn't needed. I disagreed with some of their positions, but I listened. The nuclear power they opposed would have replaced old coal plants with serious carbon dioxide emissions, but that issue hadn't yet surfaced. Today some of them are rethinking their stance on alternative sources of power as they confront climate change.

Stake in the Ground

I tried to create a collaborative environment internally as well as externally. I strongly believed that we needed a culture respectful of divergent views, in which problems could be identified early and unconventional solutions could be found.

The 100 days gave me time to learn the business and the personal dynamics. Then I prioritized my tasks. Near the top of my list was one that had arisen in a meeting with a state senator who chaired the environmental committee: PSI needed to integrate environmental risks into its decision making. Failure to do so had nearly caused the company to break down. Prior management hadn't seen the risks from environmental opposition as legitimate until it was too late.

I proposed that we study the corporate environmental charters of other utilities and then create one for PSI. To my surprise, we found not one utility with a board-adopted public statement about environmental considerations in its decision making. We decided to write a charter by convening our diverse stakeholders: customers, investors, state government officials, consumer advocates, employees, and environmentalists. Some members of my team worried that dialogue would further empower groups that opposed us and would evolve into a negotiation. They were right—but that was part of the reason for doing it. We wanted a charter that established enough common ground that we would never again waste billions of dollars on half-constructing a plant.

We held meetings with about two dozen leaders from different stakeholder groups. Each meeting began with an acknowledgment of our objective: to provide clean, affordable, and reliable electricity to our 575,000 customers 24 hours a day, 365 days a year. Everyone agreed with this mission, but environmentalists focused on "clean," consumer advocates stressed "affordable," and factory owners put a premium on "reliable." Nevertheless, the framework gave everyone in the room insight into the practical trade-offs involved in providing universal access to electricity. Using that

framework, we negotiated a 10-point corporate charter. (See the sidebar "What Rogers Learned on His 'Listening Tour.'")

Our board ratified the charter in 1990. We printed it in our annual report, and I hung a copy above my desk. We had planted a stake. Now we needed to follow our words with actions.

The First Cap and Trade

Acid rain became more prominent in the public debate in 1989, after the findings of a 10-year federal government study on the effects of sulfur dioxide emissions were released. I spent two months consulting various experts on the issue, and met with members of Congress in Washington. I concluded that legislation to curb SO_2 emissions was inevitable. The practical questions were: What would that legislation look like? What impact would it have on customers in Indiana and the 22 other states that generated more than 50% of their electricity from coal?

President George H.W. Bush soon began championing an innovative market-based solution called cap and trade. Instead of the Environmental Protection Agency's traditional command-and-control approach, Bush—in collaboration with the Environmental Defense Fund and other groups—proposed a declining cap on SO_2 emissions. The cap would be combined with an emissions-trading mechanism and a declining allocation of free allowances to spur innovation and create a market for new low-cost solutions.

Cap and trade was a smart and creative compromise. It departed from uniform regulations that failed to consider the generating portfolios and geography of individual utilities. It generously allocated allowances to utilities in coal-dependent states in the early years and provided incentives to open low-sulfur coal mines. Most important, it enabled utilities to modernize their plants and meet aggressive emissions targets without sending electricity prices skyrocketing.

I assumed that my industry peers took a similar view of this idea. However, most executives at the 1989 annual meeting of our trade association, the Edison Electric Institute, were opposed to government action. The CEOs of the largest utilities took the hardest line. They disputed the science. They argued that the health hazards hadn't been proved and that the technology to reduce emissions was too expensive. Most of them were dismissive when I spoke up to ask, "Isn't there a way we can support this to our benefit? The technology is evolving, and it seems like we could do this."

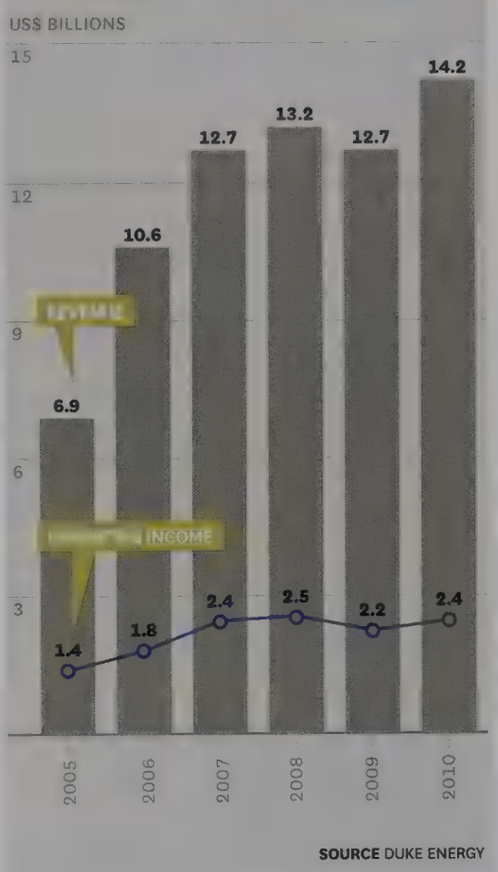
These power brokers saw PSI as a small player without influence and me as a young guy not yet aware of how the industry worked. But my belief deepened that some form of cap and trade would come about and that our stakeholders would benefit if we took a stand in front of the issue. After all, as a regulated utility, we earned a return on all our capital expenditures, including those for environmental compliance.

In the spring of 1990 I testified before Congress in support of market-based cap and trade. Some of my industry peers were upset by my action, but others began to acknowledge that the world was changing, and having a seat at the table could be helpful. It was certainly helpful for PSI. The Clean Air Act Amendments established cap and trade that year, and PSI and other coal-dependent utilities were allocated a relatively high number of allowances, which gave us time to make a deliberate and sustainable transition to cleaner generation.

The results spoke for themselves. From 1990 to 1993 our market capitalization increased by more than 65%, from $900 million to $1.5 billion. Significantly, this increase in shareholder value did not come at the expense of our customers. In fact, we lowered our real price of electricity in Indiana from 6.2 cents to 5.87 cents per kilowatt hour. Our rates were among the most affordable in the country. By 1995 we had also reduced our SO_2 emissions by 30%.

Our ties to local communities strengthened as PSI developed more of a national reputation. That helped us grow and attract new talent to the company. In 1994 we merged with Cincinnati Gas & Electric,

Duke Energy's Revenues & Income



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effectively doubling our size and extending our service territory into Ohio and Kentucky. Among my first actions as CEO of Cinergy—the new company—was to create an updated environmental charter, which was adopted at the first meeting of the board.

Fast-forward a decade to the issue of global climate change. Here, too, we were early advocates for action. As we investigated the science connecting carbon emissions to the rise of the earth's temperature, I remembered the days of the acid rain debates. I heard similar voices of resistance and denial among my peers at industry meetings. But this time we were a major player in the room. In 2006 Cinergy merged with Duke Energy, headquartered in Charlotte, North Carolina, and I was named chairman, president, and CEO.

The Tide of a Low-Carbon Future

"There is a tide in the affairs of men," Shakespeare wrote. After a deeper investigation into climate change, it became clear to me that the science was sound: Burning fossil fuels contributes to global warming. As an

What Rogers Learned on His "Listening Tour"

PSI's 1990 Environmental Charter

INCORPORATE environmental considerations into our planning process.

CONSIDER AND COMPARE the environmental consequences of choosing certain suppliers and contractors when purchasing supplies or services.

MAINTAIN AND ENHANCE internal procedures for handling environmental emergencies and meeting other environmental requirements; periodically conduct formal reviews and report results to the board of directors.

EDUCATE all employees on the importance of their corporate conduct in protecting our environment as well as their own health and safety.

MAKE environmental responsibility and innovation a guideline for measuring employee performance.

MAKE available to employees, customers, and the community all relevant information on emissions, waste products, and PSI Energy activities which may affect their health and safety.

SEEK AND IMPLEMENT cost-effective technologies and practices to minimize emissions, and reduce or safely dispose of waste products in our operations.

PURSUE methods to prevent pollution and conserve raw materials, including recycling waste and promoting the efficient use of energy by our customers through cost-effective means.

PROMOTE sound environmental practices within our industry, including the sharing of experiences with others and the continued support of research and development in environmental improvement.

DEVELOP AND MAINTAIN open and constructive relationships with environmental groups, regulatory agencies, public officials, business and residential customers, employees, and concerned citizens.

industry, we needed to figure out how to operate in a carbon-constrained world. As a company, we needed to understand the issue, stay ahead of it, and help shape a sustainable solution. And, just as when I was the new CEO of PSI, we needed to build a diverse coalition of stakeholders who could collaborate, negotiate, and proactively face the challenge.

In July 2006, thanks in large part to the leadership of General Electric and the World Resources Institute, a first-of-its-kind coalition of 22 companies (16 of them on the *Fortune* 500) and five leading environmental organizations created the U.S. Climate Action Partnership. The purpose of USCAP was to urge the federal government to enact strong legislation to reduce greenhouse gas emissions. As soon as USCAP was launched, critics tried to discredit it. A few people even called on me to resign as chairman of the Edison Electric Institute.

Those reactions weren't surprising. We knew we were taking a risk, and we had anticipated resistance. A key moment occurred at an EEI board meeting in January 2007, shortly before USCAP issued its first public call to action. I proposed that we go around the room and let each CEO express his or her views. Some of those from small and midsize utilities spoke forcefully about our need as an industry to deal with the realities of carbon emissions. Surprisingly, no one openly disagreed. Even the most skeptical CEOs acknowledged that if we didn't have a seat at the table, we would be on the menu. We left that important meeting with an industry consensus: The way we produced and consumed electricity was not sustainable, and we needed a set of principles to guide our support for legislation establishing a price on carbon.

Cap and Trade, the Sequel?

Over the past four years USCAP and EEI have advocated for a comprehensive cap and trade policy for carbon. They have helped give the business community a voice in the discussion about how to responsibly transition to a low-carbon future. Recently, however, our efforts have suffered a setback owing to political gridlock and misunderstandings. This is unfortunate, because the longer we wait as a nation, the more difficult it will be for the U.S. to remain competitive in the new energy economy. We need bipartisan solutions, because regulatory uncertainty complicates business decision making. This is especially true for utilities, whose investment decisions are based on time horizons of 20 to 60 years.

> We have been living on borrowed time in the U.S. electricity markets.

Regardless of what happens in Washington, the fact is that we have been living on borrowed time in the U.S. electricity markets. The real price of electricity remained flat for more than five decades in much of the country, largely because we didn't replace our aging power plants. Many of them were built in the 1950s, 1960s, and 1970s; as they are retired and replaced, the price of electricity will increase substantially.

Absent a constructive national energy policy, we must continue to innovate and integrate new technology that will help us generate cleaner, more sustainable electricity. Once again, we find ourselves collaborating with groups that some may consider controversial. For example, we've formed partnerships with a number of leading energy companies in China to share best practices and learn from the Chinese as they bring new energy technologies to scale. My bet is that technology developed from unique collaborations will bring us to a low-carbon future faster than national or worldwide policy can. But we still need smart government action. We still need a road map, for the sake of business, society, and the environment.

So when I'm on the road these days speaking about our vision, and I'm asked that question: "How can you advocate for a low-carbon future...?" my answer begins with four words: "How can we not?"

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Before I published *The Innovator's Dilemma*, I got a call from Andrew Grove, then the chairman of Intel. He had read one of my early papers about disruptive technology, and he asked if I could talk to his direct reports and explain my research and what it implied for Intel. Excited, I flew to Silicon Valley and showed up at the appointed time, only to have Grove say, "Look, stuff has happened. We have only 10 minutes for you. Tell us what your model of disruption means for Intel." I said that I couldn't—that I needed a full 30 minutes to explain the model, because only with it as context would any comments about Intel make sense. Ten minutes into my explanation, Grove interrupted: "Look, I've got your model. Just tell us what it means for Intel."

I insisted that I needed 10 more minutes to show how the process of disruption had ward the high end, undercutting the traditional steel mills.

When I finished the minimill story, Grove said, "OK, I get it. What it means for Intel is…," and then went on to articulate what would become the company's strategy for going to the bottom of the market to launch the Celeron processor.

I've thought about that a million times since. If I had been suckered into telling Andy Grove what he should think about the microproces-

FIRST PLACE

"How Will You Measure Your Life?"
July–August 2010

The author is **Clayton M. Christensen,** the Robert and Jane Cizik Professor of Business Administration at Harvard Business School.

SECOND PLACE

"The Age of Customer Capitalism"
January–February 2010

The author is **Roger Martin,** the dean of the Rotman School of Management at the University of Toronto.

"Stop the Innovation Wars"
July–August 2010

The authors are **Vijay Govindarajan,** the Earl C. Daum 1924 Professor of International Business and founding director of the Center for Global Leadership at Dartmouth's Tuck School of Business, and **Chris Trimble,** who is on the faculty at Tuck and is an expert on innovation within established organizations.

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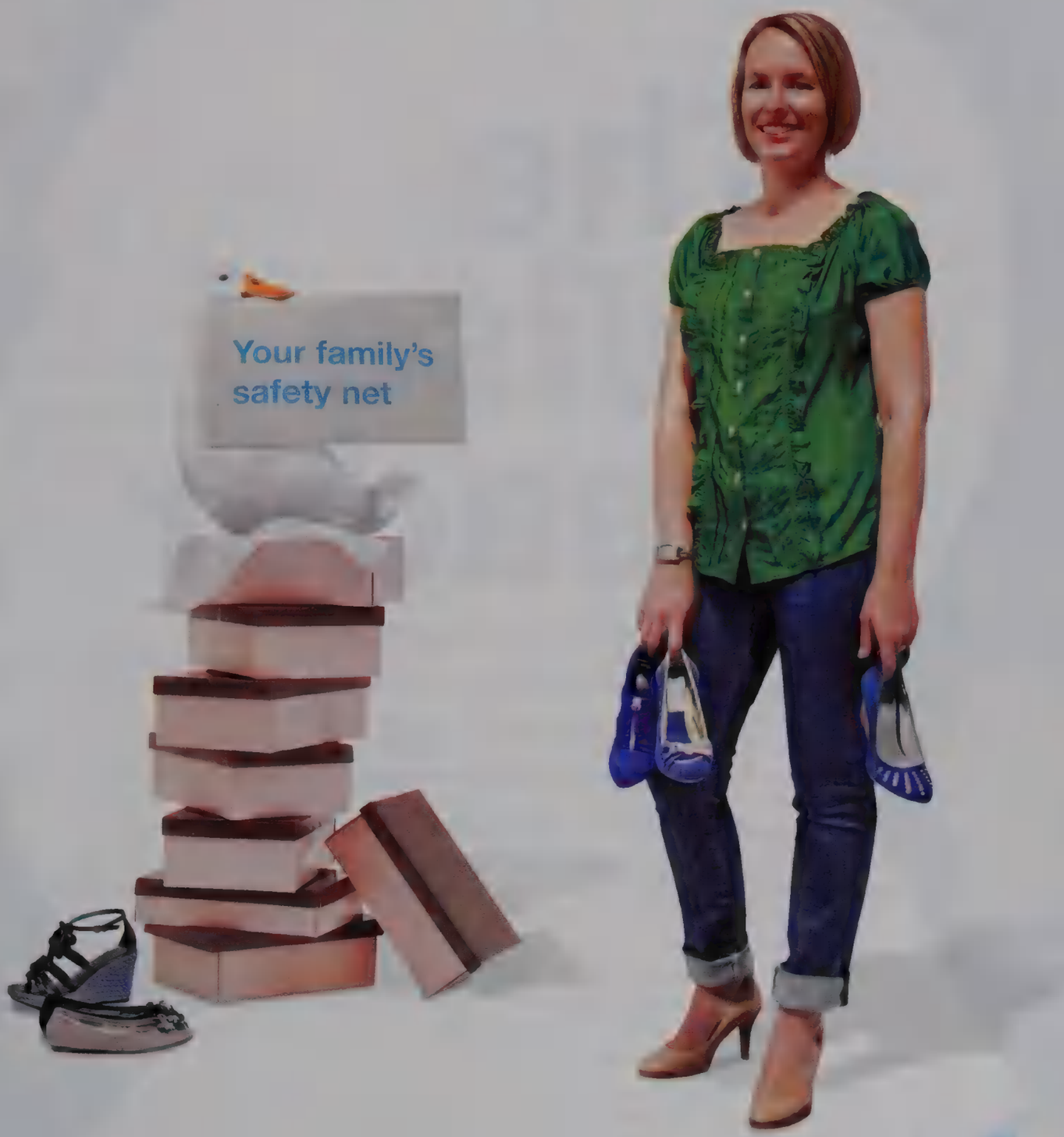
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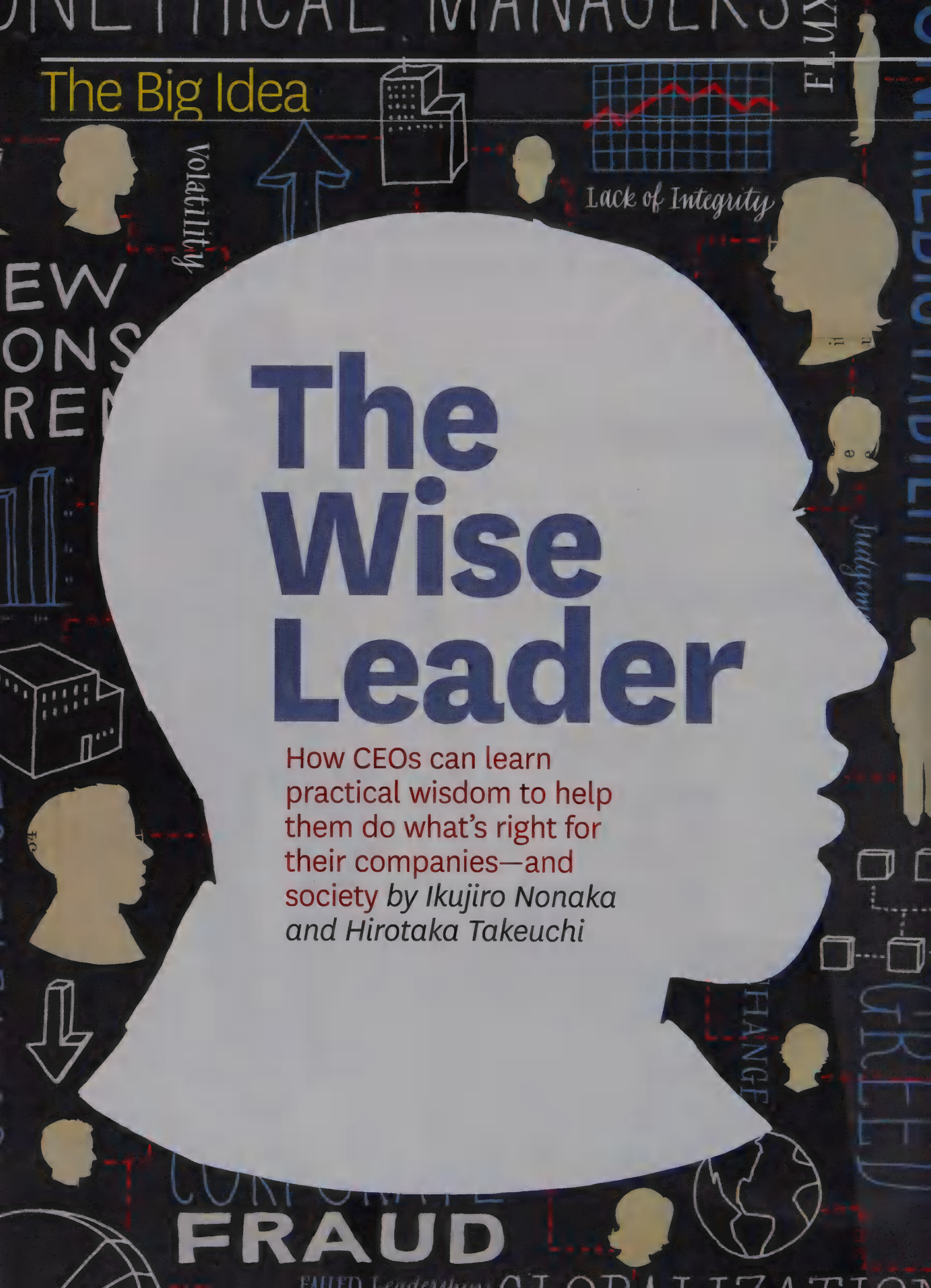
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The Big Idea



The Wise Leader

How CEOs can learn practical wisdom to help them do what's right for their companies—and society *by Ikujiro Nonaka and Hirotaka Takeuchi*

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In an era when discontinuity is the only constant, the ability to lead wisely has nearly vanished. All the knowledge in the world did not prevent the collapse of the global financial system three years ago or stop institutions like Lehman Brothers and Washington Mutual from failing.

No one could slow down the recession as it sped across the world, or ensure that market leaders like General Motors and Circuit City didn't go bankrupt. No one realized that despite enormous government stimuli, the road to recovery would be torturous, with so few jobs created in the U.S. and Japan. Never did we expect more of leadership—and never have we been so disappointed.

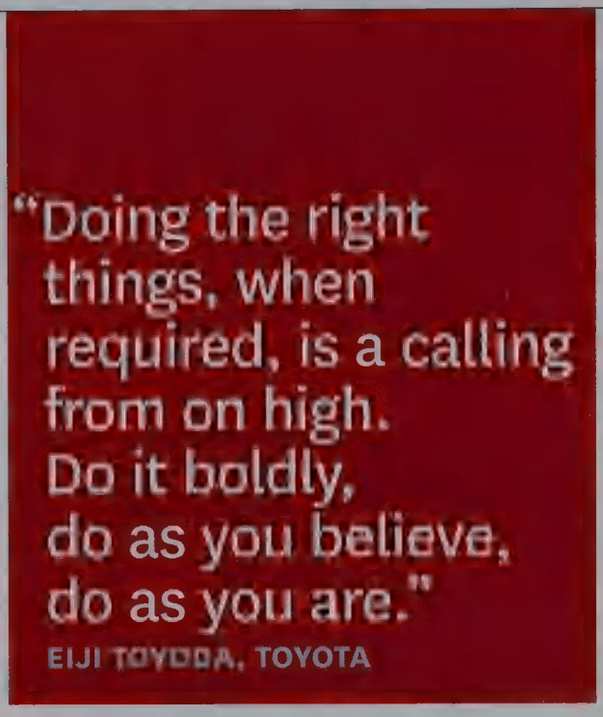
It isn't uncertainty alone that has paralyzed CEOs today. Many find it difficult to reinvent their corporations rapidly enough to cope with new technologies, demographic shifts, and consumption trends. They're unable to develop truly global organizations that can operate effortlessly across borders. Above all, leaders find it tough to ensure that their people adhere to values and ethics. The prevailing principles in business make employees ask, "What's in it for me?" Missing are those that would make them think, "What's good, right, and just for everyone?" The purpose of business, executives still believe, is business, and greed is good so long as the SEC doesn't find out.

The gulf between the theory and practice of ethics exists in business for several reasons: There is a big difference between what top management preaches and what frontline people do. There's a philosophical tendency in the West, following Plato, to conclude that if a theory isn't working, there must be something wrong with reality. People behave less ethically when they are part of organizations or groups. Individuals who may do the right thing in normal situations behave differently under stress. And common rationalizations, such as that you are acting in the company's best interest, or justifications, such as that you will never be found out, lead to misconduct.

Hit by fraud, deceit, and greed, people are angry about the visible lack of values and ethics in business. There's something wrong with the way B-schools, companies, and leaders are developing managers. As Bent Flyvbjerg pointed out in *Making Social Science Matter* (Cambridge, 2001), instead of trying to emulate the natural sciences, we should have ensured that management asked questions such as "Where are we going?" "Who gains, who loses, and by which mechanisms of power?" "Is this development desirable?" "What should we do about it?"

For leaders to cope with these myriad pressures, knowledge is more critical than ever before. Sixteen years ago we published *The Knowledge-Creating Company*. Since then executives have come to recognize that knowledge can yield sustainable competitive advantage. Companies have learned to capture, store, and distribute knowledge, so it continually catalyzes innovation. However, as we have seen, leading a knowledge-creating company is difficult.

Why doesn't knowledge result in wise leadership? The problem, we find, is twofold. Many leaders use knowledge improperly, and most don't cultivate the right kinds. The types of knowledge we discussed



in our book are now well known: explicit and tacit. Managers tend to rely on explicit knowledge, because it can be codified, measured, and generalized. Wall Street firms thought they could manage greater risk by using numbers, data, and scientific formulas instead of making judgments about loans one at a time. The same holds for the U.S. automobile industry, which relies on offering financial incentives rather than understanding customer needs.

Dependence only on explicit knowledge prevents leaders from coping with change. The scientific, deductive, theory-first approach assumes a world independent of context and seeks answers that are universal and predictive. However, all social phenomena—including business—are context dependent, and analyzing them is meaningless unless you consider people's goals, values, and interests along with the power relationships among them. Yet executives fail to do just that.

Leaders will continue to rely on new scientific discoveries to deal with the environmental, energy, and biodiversity issues facing the globe and on technological advances to develop smarter systems. Creating the future, however, must extend beyond the company; it must be about pursuing the common good. CEOs need to ask if decisions are good for society as well as for their companies; management must serve a higher purpose. Companies will then start thinking of themselves as social entities charged with a mission to create lasting benefits for society. Unless companies create social as well as economic value, they will not survive in the long run.

In addition, the world needs leaders who will make judgments knowing that everything is contextual, make decisions knowing that everything is changing, and take actions knowing that everything depends on doing so in a timely fashion. They will have to see what is good, right, and just for society while being grounded in the details of the ever-changing front line. Thus they must pair micromanagement with big-picture aspirations about the future.

Over the past two decades we have been studying leadership in different kinds of organizations; teaching business leaders, especially in Japan; and interviewing generations of leaders in some of the best companies in the world. Our goal has been to identify how leaders can systematically make decisions that will allow companies to live in harmony with society rather than clash with it. Our studies show that the use of explicit and tacit knowledge isn't enough; CEOs must also draw on a third, often forgotten kind of knowledge, called practical wisdom. Practical wisdom is tacit knowledge acquired from experience that enables people to make prudent judgments and take actions based on the actual situation, guided by values and morals. When leaders cultivate such knowledge throughout the organization, they will be able not only to create fresh knowledge but also to make enlightened decisions.

From Knowledge to Wisdom

The origin of practical wisdom lies in the concept of *phronesis,* one of the three forms of knowledge that Aristotle identified. In *Nicomachean Ethics* VI.6, he wrote that phronesis is "a true and reasoned state of capacity to act with regard to the things that are good or bad for man." He identified two types of wisdom: esoteric or metaphysical wisdom, and practical wisdom, which Samuel Coleridge later wryly interpreted as "common sense in an uncommon degree."

Practical wisdom, according to our studies, is experiential knowledge that enables people to make ethically sound judgments. It is similar to the Japanese concept of *toku*—a virtue that leads a person to pursue the common good and moral excellence as a way of life. It is also akin to the Indian concept of *yukta,* which connotes "just right" or "appropriate." For instance, executives who believe that the purpose of a business—and even of making profits—is to serve people and enhance society's well-being observe yukta and shy away from excess and greed.

Aristotle also identified *episteme,* or universally valid scientific knowledge, and *techne,* or skill-based technical know-how. If episteme is know-why and techne is know-how, phronesis is know-what-

Idea in Brief

Business now demands a different kind of leader—one who will make decisions knowing that the outcomes must be good for society as well as the company. Leaders must keep a higher purpose in mind.

Although such leadership demands more knowledge than ever, executives should not depend on just explicit or tacit knowledge. They also need a third, often forgotten kind of knowledge, called *phronesis*, or practical wisdom.

Phronesis, acquired from experience, enables people to make prudent judgments in a timely fashion and take actions guided by values and morals. When leaders distribute such knowledge within their organizations, they can reach enlightened decisions.

Japan has a number of phronetic leaders, who possess six abilities: They can assess what is good; quickly grasp the essence of situations; create contexts for learning; communicate effectively; exercise political power to bring people together; and encourage the development of practical wisdom in others through apprenticeship and mentoring.

should-be-done. For instance, because no universal notion of a good car exists, episteme cannot answer the question "What is a good car?" That will depend on who is using the car and why, and it will change over time. Techne is knowing how to make a car well; phronesis is knowing both what a good car is and how to build it. Thus phronesis enables managers to determine what is good in specific times and situations and to undertake the best actions at those times to serve the common good.

To make the right decisions, managers need to understand why a company exists—its raison d'être. Companies often behave as though they're willing to do anything to survive, even if that means destroying the world in which they operate. They would do better to pursue the common good—not because it's right or fashionable but to ensure their sustainability. No company will survive over the long run if it doesn't offer value to customers, create a future that rivals can't, and maintain the common good.

We have observed the use of phronesis most often in Japan, although it isn't specific to any country or culture. Governments in Japan may have come under fire for the mistakes they have made, but people still respect Japanese companies even though they haven't proved to be world-beaters in recent times. Before the devastating earthquake and tsunami, there was no crisis of confidence in Japan's corporate world as there is in America's, partly because what happened on Wall Street did not happen in Japan. Japanese companies have often been criticized for not being sufficiently capitalistic—that is, not returning enough capital to investors, not maximizing shareholder value in the short term, not moving quickly with offshoring, not laying off employees to reduce costs, not paying compensation that will incentivize top management. But the flip side is a continuing belief that the best Japanese companies live in harmony with society, have a social purpose in earning profits, pursue the common good as a way of life, have a moral purpose in running a business, and practice distributed phronesis.

These beliefs will influence tomorrow's management theory and practice. Indeed, they are the very essence of what Gary Hamel described in his article "Moon Shots for Management" (HBR February 2009). In contrast to the old notion of capitalism, which pitted business and society against each other, the best Japanese companies, we believe, can become the exemplars of a new, communitarian approach to capitalism, as long as their leaders continue to imbue it with a social purpose.

The Six Abilities of Phronetic Leaders

It isn't easy to lead with practical wisdom. A phronetic leader must make judgments and take actions amid constant flux. And he or she must do so while taking a higher point of view—what's good for society—even though that view stems from individual values and principles. Our research over the past decade shows that to lead in this fashion, six abilities are essential. We will describe them in the following pages and offer suggestions on how to develop those skills.



Wise Leaders Can Judge Goodness

Phronetic leaders practice moral discernment about what's good and act on it in every situation. Don't get us wrong—maximizing shareholder wealth can lead to goodness, as can making a profit. But these leaders set their sights higher: They believe that their actions should have a moral purpose akin to what Max Weber had in mind when he linked Protestantism to capitalism.

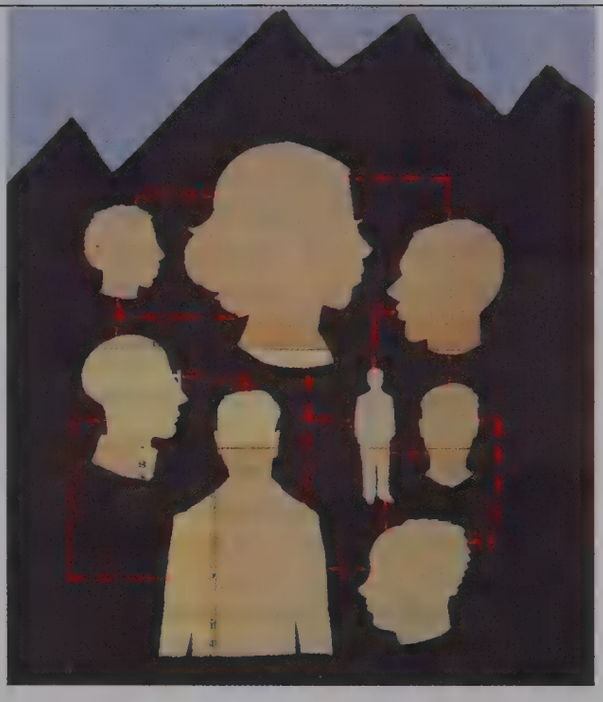
According to Akio Matsubara, the former head of human resources at Toyota, Eiji Toyoda, the com-

Teaching Integrity in the Classroom

Since 2008 we have been developing a program to help create leaders who apply practical wisdom in Japanese companies. The Knowledge Forum, as we call it, takes place primarily at Hitotsubashi University's downtown Tokyo campus and is essentially a *ba* ("shared context") where executives can build character and integrity.

The program kicks off by assembling 30 senior executives at Mt. Takao, a 90-minute drive from central Tokyo, for a day of physical exercises intended to build teamwork. During the intense 15-month program, executives share their most compelling life experiences and defining moments of failure and success, both on and off the job. That helps them empathize with one another.

Executives share their most compelling life experiences and defining moments of failure and success.



pany's former president, always said, "To do what you believe is right. To do what you believe is good. Doing the right things, when required, is a calling from on high. Do it boldly, do as you believe, do as you are."

Judgments must be guided by the individual's values and ethics. Without a foundation of values, executives can't decide what is good or bad. His values spur Shoei Utsuda, the chairman of Mitsui & Co., to ask before making any decision, "Is what I am attempting to do good quality work (*yoi shigoto*) for the company and society?" Values have to be one's own; they can't be borrowed. That's why the question most frequently asked at Honda is "What do you think?" It encourages employees to reflect deeply about their own values in relation to those of Honda and society.

Managers must make judgments for the common good, not for profits or competitive advantage. Says Tadashi Yanai, the CEO of Fast Retailing, which owns Japan's fastest-growing apparel brand, Uniqlo, "Not only does a company have to live in harmony with society, but to be accepted, it must contribute to society. The majority of companies that have failed did not maintain that balance. Everyone is, first, a member of society before one of the company. Thinking only about the company will undoubtedly result in failure."

There are four ways of cultivating the ability to make judgments about goodness. One is experience, particularly that gained by facing adversity or failure. Yanai constantly reminds himself and others of the challenges he overcame—operating a single store way out in the country, being refused a bank loan, being pushed around by powerful wholesalers, facing near bankruptcy on numerous occasions. Yanai is so proud of having made mistakes that he called his first book *One Win, Nine Losses*.

Another way is to write down principles drawn from life experiences and share them. Over the years, Yanai has developed 23 principles, which he calls the "soul" of his company. "Without a soul, a company or a person is nothing more than an empty shell," he says. Several of his canons address goodness head-on: Put good ideas into practice, move the world, change society, and contribute to society. Reward good conduct and punish evildoing. Demand the highest level of ethics in your business and work.

A third method is the relentless pursuit of excellence. That helps CEOs realize what's worthwhile—what's worth desiring and striving for—in a specific situation. Utsuda told us that he once served as an assistant to Mitsui's former president Tatsuzo Mizukami, who revived the company after World War II: "He had already turned 80 when I worked for him. I was amazed at the standards of excellence he pursued. Never once did he cut corners."

Finally, judgment can be cultivated by becoming well versed in the liberal arts, such as philosophy, history, literature, and the fine arts. Management is

The CEOs interact with scholars of philosophy, history, literature, political science, military strategy, and economics to deepen their understanding of the liberal arts. They discuss the work of Peter Drucker and meet 12 B-school faculty members at weekly coaching sessions. The Knowledge Forum requires a substantial time commitment from executives as well as from the faculty.

Over the next nine months participants meet frequently to discuss issues and to socialize over drinks, golf, and karaoke. Full-day sessions, held once a month, end in a publike atmosphere to stimulate more discussion. The executives also come together in a formal ba for three days to kick off a project that involves writing an article, ostensibly for *Harvard Business Review,* on a Japanese management practice that has global impact.

There are other such programs in Japan. Twenty years ago Yotaro Kobayashi, the former CEO of Fuji Xerox, started Camp Nidom, which is held at Fuji Xerox's center in Karuizawa, Nagano. An annual gathering of 20 or so influential Japanese CEOs and their spouses, it combines the study of business and the liberal arts. For the past 20 years we have both taught at Camp Nidom.

a liberal art, as Peter Drucker said; liberal because it deals with the fundamentals of knowledge, self-knowledge, wisdom, and leadership; art because it is also about practice and application. To follow through on what we preach, a few years ago we launched a senior executive program in Tokyo (see the sidebar "Teaching Integrity in the Classroom") whose core curriculum consists of Aristotle, Machiavelli, Heidegger, and other classics.



Wise Leaders Can Grasp the Essence

Before making judgment calls, wise leaders quickly sense what lies behind a situation, project a vision of the future or the consequences, and decide on the action needed to realize that vision. Practical wisdom enables them to see the essence and intuitively fathom the nature and meaning of people, things, and events.

A telling example of how Soichiro Honda, the founder of the company that bears his name, did that is visible in a photograph hanging at the Automotive Hall of Fame in Dearborn, Michigan. It shows him at a motorcycle-racing track, crouching down low to put himself at eye level with a rider passing at full speed. Honda has his hands on the ground to feel the vibration and his ears cocked to absorb the sound of the engine. That's how he captured the essence of the motorcycle. "When I look at a motorcycle, I see many things," he used to tell his successors. "I see I should do such and such to maneuver past the curve. I think about the next-generation machine. I think, if I do this, it will have more speed. I move naturally into the next process." Grasping the essence requires attention to detail and persistence. "If you are going to do something, you must do it relentlessly," Yanai says. "Do what is 100% right, concentrate on small things, and continue going back to basics. Unless you do that, you cannot move to the next stage. The secret to success is doing the basics day in and day out."

It's also important that leaders grasp universal truths from the particulars and the details. Expanding particulars into universals requires continual interaction between subjective intuition and objective knowledge. Ratan Tata, the chairman of the Tata Group, conceived the idea of a $2,500 car in this way. In the now famous story, he noticed an entire family—father, mother, and children—on a scooter, snaking dangerously around cars on a rainy day in Mumbai. He knew that the cheapest car cost five times as much as a scooter did and that families near the bottom of the income pyramid couldn't afford one. Tata realized, right there and then, that those people would buy cars if his company produced them at a price they could afford.

To cultivate their ability to grasp the essence of a problem, executives should practice three mind-stretching routines. The first is relentlessly asking what the basis of a problem or a situation is. At Toyota employees ask "Why?" five times to get to the root cause. At Honda they ask the "A, A0, and A00" questions. *A* questions are about specifications—such as "What should the horsepower of this engine be?" *A0* questions are about concepts—such as "What is the idea behind this engine?" *A00* questions are about the essential goals of the project—such as "What is this engine for?"

The second routine is learning to see the trees and the forest at the same time. In the words of Toshifumi Suzuki, Seven-Eleven Japan's chairman, "It isn't good if you just see a tree, not the forest. Many wrongly think that single-item management means managing a single item. But it's necessary to place the item in the store as a whole." God may live in the details, but leaders should never forget the big picture.

The Six Abilities Of Wise Leaders

Wise leaders make decisions only after they figure out what is good for the organization and society.

They can quickly grasp the essence of any situation or problem and intuitively fathom the nature and meaning of people, things, and events.

They constantly create informal as well as formal shared contexts for senior executives and employees to construct new meaning through their interactions.

They know how to use metaphors and stories to convert the essence of their actual experiences into tacit knowledge for individuals and groups.

They exercise political power to bring together people with conflicting goals and spur them to action.

They encourage the development of practical wisdom in others, especially employees on the front lines, through apprenticeship and mentoring.

The third entails constructing and testing hypotheses. For example, the employees in every Seven-Eleven Japan store—including high school students and homemakers who work part-time—decide what merchandise to order. Because each store caters to different customers and faces different situations at different times, employees cannot rely on rules set by headquarters. Nor can they mechanically fill shelves by ordering the same amounts of the same things each day. Every time a staff member places an order, she is encouraged to build a hypothesis about what customers want. When ordering beverages, for example, she must rely on her knowledge of local customers' needs and also take into account factors such as the weather, school schedules, local festivals, power shutdowns, and so on.



Wise Leaders Create Shared Contexts

Phronetic leaders constantly create opportunities for senior executives and employees to learn from one another. In Japan a *ba* (place, space, or field) refers to the context in which relationships are forged and interactions occur. Those participating in a ba share information, build short-term relationships, and try to create new meaning. For example, an informal ba may take place at a bar or a pub, where strangers talk casually about their immediate concerns or problems, sometimes triggering insights or solutions.

In a more formal or organizational setting, a ba permits participants with a shared sense of purpose to interact closely. Each member sees himself in relation to others and tries to understand their views and values subjectively. Membership is voluntary. In that sense, a ba is a shared context in motion, with participants coming and going, relationships changing, and contexts shifting over time.

Honda's *waigaya* (short for the onomatopoeic *waiwai-gayagaya,* which imitates the hum created by people's voices when they meet) is also a ba. As many as 30 members of a project team will get together for three days and nights at a hotel or *ryokan* (inn) with a hot springs. In the evenings they drink sake and visit the communal bath. Although there is no agenda, people typically begin by bad-mouthing their bosses and sharing frustrations. As the members start spilling their guts over sake, it isn't unusual for fights, verbal or even physical, to break out. On the second day, barriers start to melt as people begin to understand one another's motivations and feelings. They become more willing to listen and empathize. By the third day, they've often made an inductive leap, overcoming their personal issues and arriving at a team-based view about how to solve a problem.

Companies can set up a ba in any number of ways: in project meetings, training programs, ad hoc study groups, informal hobby groups, conferences, company-sponsored family or sports events, smoking rooms, cafés and canteens, virtual meetings, intranet systems, and blogs. A ba can be top-down or bottom-up. The CEO should initiate the former kind. Five months after Utsuda became Mitsui's president, in 2002, he started a *kurumaza* (sitting in a circle) meeting that took place once or twice a month during lunch or after work. It was open to any employee who registered on the company intranet and wanted to discuss the meaning of good-quality work for employees, the company, and society. Over six years, 117 meetings involving 2,000 employees took place. The participants reviewed Mitsui's past business practices—some of which were controversial, owing to compliance issues in foreign countries—and future aspirations.

A bottom-up ba, which companies outside Japan may find easier to use, gives employees firsthand experience of how consumers use products and services. Eisai, known for having developed medicines to treat dementia, sends all its researchers to take care of patients. The employees learn how patients behave, take medicines, bathe, and communicate with caregivers. They gain a deeper understanding of the needs of patients and their families—and of the company's mission of human health care as articulated by Haruo Naito, Eisai's president. One employee told us, "I was completely focused on the development of medicines, but at the hospital, the focus was not on medicines. Drugs are only useful in certain situations. The training gave me fresh awareness of the purpose of drugs and how we should develop them."



Wise Leaders Communicate the Essence

Phronetic leaders must be able to communicate in a way that everyone can understand. The essence of a situation is often hard to express, so they must use stories, metaphors, and other figurative language. That allows individuals grounded in

different contexts and with different experiences to grasp things intuitively.

A metaphor provides a way of understanding one thing by envisioning another. Yanai is fond of using sports metaphors and analogies to get his point across. One of his favorites is "In baseball, teams with a large number of stolen bases have a high number of attempted steals. You can't run if you're thinking only about not being tagged. The same could be said of management." Metaphors also convey messages in ways that capture the imagination. For example, Toyota likens the automobile industry—and, by extension, the company itself—to a green tomato, incomplete and growing.

A story can help us gain self-knowledge through the experiences of the protagonist or the antagonist. It can also explain the historical context ("How has this come to be?") and communicate future scenarios ("What is it going to look like?"). At Mitsui, storytelling became an important part of the review process under Utsuda. In 2002 he changed the corporate performance criteria, putting much more emphasis (80%) on qualitative than on quantitative results. The process for achieving results thus became more important than revenues or profits. Utsuda encouraged all employees to tell a story at their annual review about why a goal was important to them and the company, how it aligned with their values as well as the company's, and what good it would do them and the company in the future. The process of creating, telling, and sharing stories was instrumental in changing Mitsui's culture. It led employees to sell their ideas more persuasively and made them think about the quality of the work they would do before calculating the profits.

Fujio Mitarai, Canon's chairman, has institutionalized a similar process. He asks everyone to submit an annual business plan with a story. He kicks off the process by writing a story about how the company can achieve the numerical goals he has established. That trickles down through senior managers and middle managers to all employees. Everyone at Canon has to back up the numbers with a narrative. "That's how skills are cultivated and our people grow," Mitarai explains. "It forms the foundation of Canon's strength."

To use metaphors and stories effectively, leaders must learn to see the relationship between one thing and another, between themselves and someone else, or between the present and either the past or the future. The best way to do that is to read as many novels as possible in all genres, including romance, satire, comedy, and tragedy, and to attend the theater.

Rhetoric counts, because effective communicators touch people's hearts and minds. Think of speeches that have done both, such as Martin Luther King, Jr.'s "I have a dream" speech at the Lincoln Memorial in 1963 and Steve Jobs's "Stay hungry, stay foolish" commencement address at Stanford University in 2005. Both were based on personal experience; had a beginning, a middle, and an end; and repeated the key message several times. King said "I have a dream" eight times and "Let freedom ring" 10 times in the last five minutes of his 17-minute speech. Jobs repeated the phrase "Stay hungry, stay foolish" three times in the last 20 seconds of his 15-minute address.

Wise leaders engage in conversation with as many people as possible and display a high degree of commitment to communication. Yanai articulated his "dream" for 2020 on January 1, 2009: to become the world's number one apparel retailer in terms of sales and profitability, surpassing Gap, Zara, and H&M. Over the next three months he engaged in a weekly 90-minute dialogue with half a dozen of his top executives in Tokyo to discuss the people, organization, and systems needed to realize that dream. He spent the same amount of time in similar meetings with another group of top executives from Shanghai, Seoul, Paris, London, and New York. He plans to carry on these dialogues with 200 of his future leaders, meeting them face-to-face all over the world in the next three years. Communication is critical to bringing dreams to life.



Wise Leaders Exercise Political Power

It isn't enough to identify the essence or communicate it; phronetic leaders must bring people together and spur them to act, combining and synthesizing everyone's knowledge and efforts in the single-minded pursuit of their goals. To mobilize people, executives must utilize all the means—including Machiavellian ones—suited to the situation. Shrewdness and stubbornness are often necessary to create something new and good.

Wise leaders exercise political judgment by understanding the viewpoints and emotions of others, gleaned through everyday verbal and nonverbal communication. They carefully consider timing—when to make a move or to discuss issues. No one

"Concentrate on small things, and continue going back to basics. Unless you do that, you cannot move to the next stage."
TADASHI YANAI, FAST RETAILING

we know exercises these qualities with more passion than Toshiba's chairman, Atsutoshi Nishida, who is a scholar of intersubjectivity—a field of phenomenology pioneered by Edmund Husserl. Nishida firmly believes that people are by nature both logical and emotional, so he stresses the importance of empathizing with others to develop genuine dialogues with them. It isn't unusual for him to engage in discussions with his colleagues that run twice the allotted time.

Phronetic leaders also strive to understand all the contradictions in human nature—good and bad, civility and incivility, optimism and pessimism, diligence and laziness—and synthesize them as situations arise. Rather than seeking an optimal balance between contradictions, they engage in dialectical thinking, which enables them to deal with contradictions, opposites, and paradoxes by moving to a higher level. Some use the German word *aufheben* to describe this process. By thinking in terms of "both and" rather than "either or," phronetic leaders can make the decision best suited to a situation without losing sight of the goodness to be achieved. As F. Scott Fitzgerald pointed out, "The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function." In this age of discontinuity, these qualities matter more than ever.

Imagination and vision are key to rising to a higher level. For instance, Yanai has announced that Fast Retailing will need 200 next-generation leaders to bring about his vision for the company. He has used dialectics to identify the starting point—namely, the composition of the leadership pool. Half the future leaders will be Japanese, half will come from current employees, half will be geniuses (and the other half will be ordinary folks). Yanai wants them to transcend all the dichotomies and turn into globally minded business owners. His leaders must be both *asura* (demon) and Buddha: They must become tyrannical perfectionists who understand both the bad and the good in human nature.

Interestingly, demoting leaders can help them understand other viewpoints and emotions. This technique works especially well in Japan, and nobody uses it more than Fast Retailing. More than half the company's senior executives have been demoted, which involves a 25% pay cut and sends a clear message that a particular judgment, decision, or action didn't work. The executives are given another chance to excel. One of them, who has experienced two demotions, says, "Sure, it hurts both economically and psychologically. But the demotions made me tougher. I now have the stomach to give my subordinates the kind of feedback I received."

Forgetting success is also effective in spurring people to do better. Yanai recently warned his team that doing the same thing year after year is synonymous with falling behind. The title of a book he wrote in 2009, *Throw Away Your Success in One Day,* shows how quickly he thinks companies must reinvent themselves.



Wise Leaders Foster Practical Wisdom in Others

Practical wisdom should never be treated as if it were the preserve of the company's chief executive or top management team. It must be distributed as much as possible through the organization, and employees at all levels can be trained in its use. Fostering distributed leadership is therefore one of the wise leader's biggest responsibilities. For instance, in the 1970s Soichiro Honda gained some practical wisdom from his subordinates when Honda was developing a low-emissions automobile engine. He declared that the new engine would put the company in a position to beat the "Big Three" automakers in the United States, who were then opposing the Clean Air Act. Honda's engineers objected, saying that they were developing the engine in order to fulfill social responsibilities. They were doing it for their children, they said. The story goes that Honda was so ashamed

of himself when he heard this that he decided it was time to retire.

Fostering distributed phronesis will enable organizations to respond flexibly and creatively to any situation. One structural option is to use the "scrum" approach (see our article "The New New Product Development Game," HBR January–February 1986) to stay agile. The rugby metaphor, first used in the manufacturing industry, is today the official name of the agile software development process. Although individual teams are usually limited to seven members, the number of teams rises as the scope of the project grows. The development process stops at two-week intervals, when members form a scrum (a "huddle" in American football) to make judgments on how to complete unfinished tasks. It's possible to have hundreds of scrum masters and thousands of members working, learning, and making wise decisions concurrently.

Even part-time workers should be able to use phronesis, according to Seven-Eleven Japan's Suzuki. "I have only two eyes and one mind," he argues. "There are several thousand part-time workers in our stores. If everyone can make a judgment on his or her own, we will have quite a few more eyes and minds."

People can often learn about practical wisdom by observing an exemplar's behavior. At Honda the company's founder is still the dominant exemplar. Takeo Fukui, a former company president, told us, "It is important for Honda to create many Soichiro Hondas." That doesn't mean Honda workers should imitate the founder; the situations they face are often different from those he faced when he was alive. Rather, it means that when a judgment call is necessary, a worker should ask himself or herself: "If I were Soichiro Honda, what would I do?"

Exemplars can frequently be found among middle managers. Consider Honda's large-project leaders, who undertake work of strategic importance but have no hierarchical authority or personnel selection power. They work with as many as 200 of their colleagues at a time in design, engineering, testing, marketing, and other fields. Those colleagues all volunteer mainly because of the leader's character. An exemplar enables ordinary people to perform in extraordinary ways.

Another method of fostering practical wisdom is to use a formal system of apprenticeship, which allows mentors to share experiences, contexts, and time. At Fast Retailing, for instance, Yanai serves as the mentor for 200 apprentices all over the world. He assigns them projects in three areas—product development, store operations, and administration (finance, human resources, IT, and legal)—and asks them to implement ideas that will change the status quo. Each project lasts about six months; apprentices work for 18 months on these jet-set projects, as employees call them, while maintaining their regular jobs. Yanai must personally evaluate the results of 600 change projects in a timely fashion, and in the process he helps create the next generation of wise leaders for the company.

TODAY'S KNOWLEDGE-CREATING company, we believe, must metamorphose into the wisdom-practicing company of tomorrow. That demands a new kind of leader—a CEO who is many things at the same time:

- a philosopher who grasps the essence of a problem and draws general conclusions from random observations;
- a master craftsman who understands the key issues of the moment and acts on them immediately;
- an idealist who will do what he or she believes is right and good for the company and society;
- a politician who can spur people to action;
- a novelist who uses metaphors, stories, and rhetoric;
- a teacher with good values and strong principles, from whom others want to learn.

That's too idealistic or too much to expect, you may say. Perhaps. But companies have to create new futures in order to survive. Those futures can no longer be extensions of the past; they must be leaps of faith into tomorrow. CEOs cannot be content to analyze situations using empirical data and deductive reasoning; they must also make inductive jumps according to their ideals and dreams. If they aren't idealistic, they simply can't create new futures.

Being idealistic isn't enough, though. Leaders must also be pragmatic—looking reality in the eye, grasping the essence of a situation, and envisioning how it relates to the larger context—if they are to judge what they must do right then and there to achieve the common good. CEOs have to become idealistic pragmatists, which is why they must turn the dual quest for knowledge and practical wisdom into a way of life.

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For the record: Ikujiro Nonaka is on the board of directors of Mitsui & Co. and Seven & I Holdings, and was on the board of Eisai until 2009. He is also an adviser to Canon. Hirotaka Takeuchi is a personal adviser to Fast Retailing's Tadashi Yanai.

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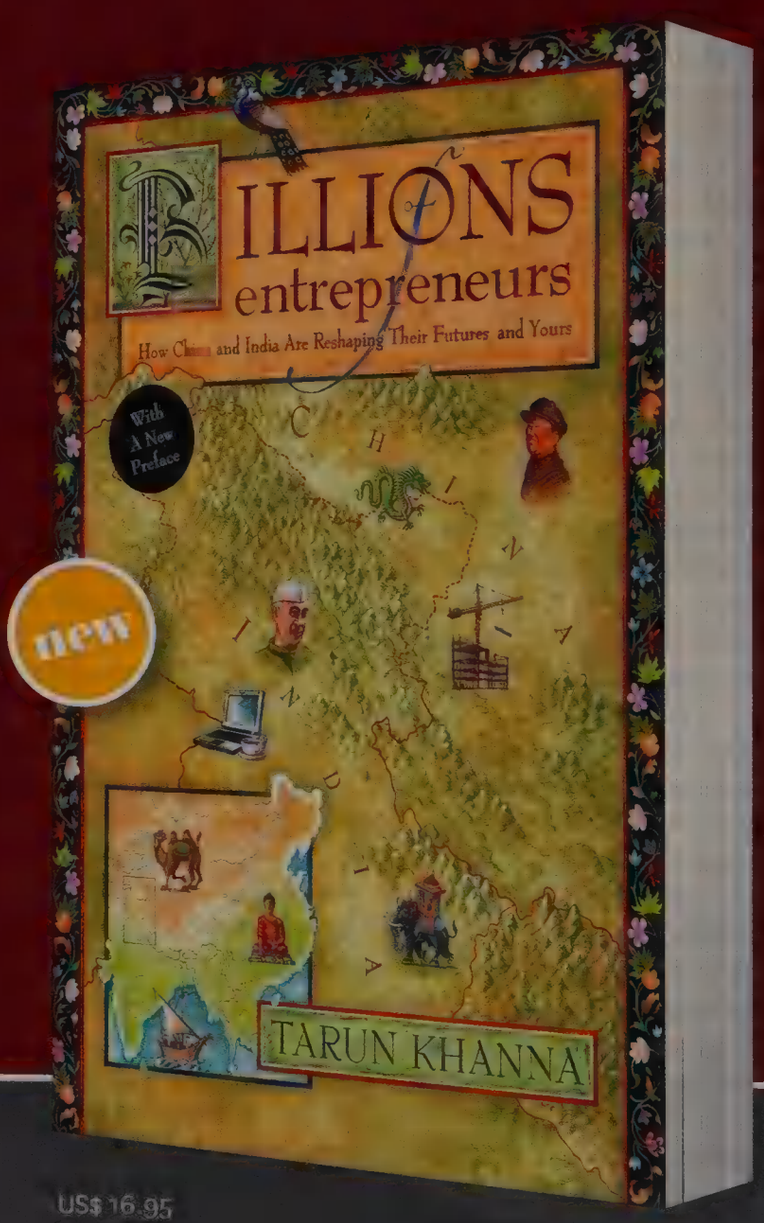
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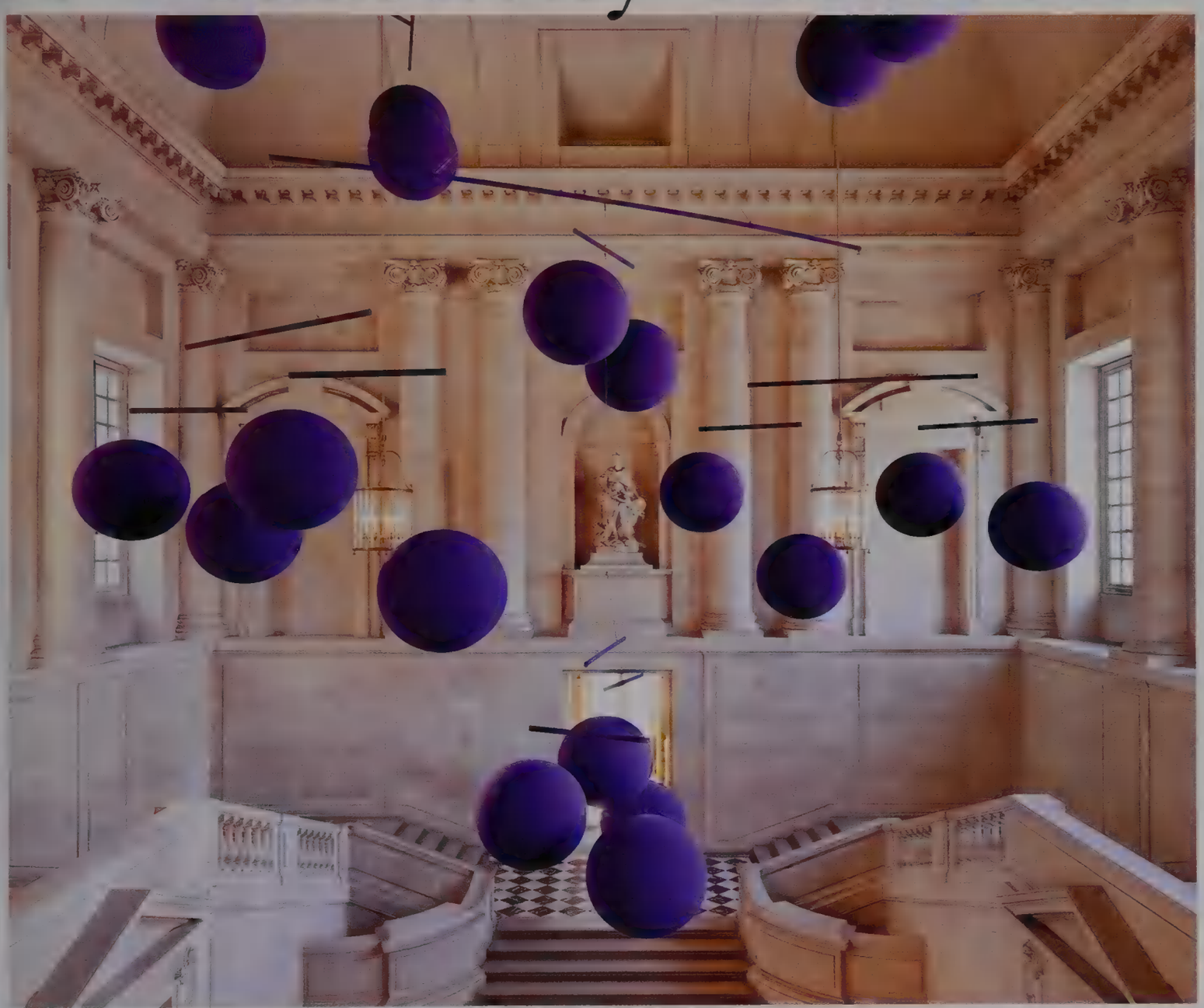
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A Productivity Guidebook



ARTWORK
Xavier Veilhan
The Mobile, 2009
composite material, stainless steel, paint, motor, 10 x 10 x 10 m
Exhibition view, Veilhan Versailles

Keys to enhancing your knowledge workers' performance, effectiveness, and satisfaction

Spotlight





ARTWORK Xavier Veilhan, *The Big Mobile*, [illegible]
Metallic structure, [illegible] spheres in PVC with diameters from 29.5" to 157.8"
Exhibition View, 3rd Biennial of Contemporary Art of Valencia

The Power Of Small Wins

Want to truly engage your workers? Help them see their own progress.

by Teresa M. Amabile and Steven J. Kramer

WHAT IS THE BEST WAY to drive innovative work inside organizations? Important clues hide in the stories of world-renowned creators. It turns out that ordinary scientists, marketers, programmers, and other unsung knowledge workers, whose jobs require creative productivity every day, have more in common with famous innovators than most managers realize. The workday events that ignite their emotions, fuel their motivation, and trigger their perceptions are fundamentally the same.

The Double Helix, James Watson's 1968 memoir about discovering the structure of DNA, describes the roller coaster of emotions he and Francis Crick experienced through the progress and setbacks of the work that eventually earned them the Nobel Prize. After the excitement of their first attempt to build a DNA model, Watson and Crick noticed some serious flaws. According to Watson, "Our first minutes with the models...were not joyous." Later that evening, "a shape began to emerge which brought back our spirits." But when they showed their "breakthrough" to colleagues, they found that their model would not work. Dark days of doubt and ebbing motivation followed. When the duo finally had their bona fide breakthrough, and their colleagues found no fault with it, Watson wrote, "My morale skyrocketed, for I suspected that we now had the answer to the riddle." Watson and Crick were so driven by this success that they practically lived in the lab, trying to complete the work.

Throughout these episodes, Watson and Crick's progress—or lack thereof—ruled their reactions. In our recent research on creative work inside businesses, we stumbled upon a remarkably similar phenomenon. Through exhaustive analysis of diaries kept by knowledge workers, we discovered the *progress principle:* Of all the things that can boost emotions, motivation, and perceptions during a workday, the single most important is making progress in meaningful work. And the more frequently people experience that sense of progress, the more likely they are to be creatively productive in the long run. Whether they are trying to solve a major scientific mystery or simply produce a high-quality product or service, everyday progress—even a small win—can make all the difference in how they feel and perform.

The power of progress is fundamental to human nature, but few managers understand it or know how to leverage progress to boost motivation. In fact, work motivation has been a subject of long-standing debate. In a survey asking about the keys to motivating workers, we found that some managers ranked recognition for good work as most important, while others put more stock in tangible incentives. Some focused on the value of interpersonal support, while still others thought clear goals were the answer. Interestingly, very few of our surveyed managers ranked progress first. (See the sidebar "A Surprise for Managers.")

If you are a manager, the progress principle holds clear implications for where to focus your efforts. It suggests that you have more influence than you may realize over employees' well-being, motivation, and creative output. Knowing what serves to catalyze and nourish progress—and what does the opposite—turns out to be the key to effectively managing people and their work.

In this article, we share what we have learned about the power of progress and how managers can leverage it. We spell out how a focus on progress translates into concrete managerial actions and provide a checklist to help make such behaviors habitual. But to clarify why those actions are so potent, we first describe our research and what the knowledge workers' diaries revealed about their *inner work lives.*

Inner Work Life and Performance

For nearly 15 years, we have been studying the psychological experiences and the performance of people doing complex work inside organizations. Early on, we realized that a central driver of creative, productive performance was the quality of a person's inner work life—the mix of emotions, motivations, and perceptions over the course of a workday. How happy workers feel; how motivated they are by an

Of all the things that can boost inner work life, the most important is making progress in meaningful work.

Idea in Brief

What could be more important for managers than increasing their teams' productivity? Yet most managers labor under misconceptions about what motivates employees—particularly knowledge workers—to do their best work.

On the basis of more than a decade of research, which included a deep analysis of daily diaries kept by teammates on creative projects, the authors clarify the matter once and for all: What motivates people on a day-to-day basis is the sense that they are making progress.

Managers who take this finding to heart will easily see the corollary: The best thing they can do for their people is provide the catalysts and nourishers that allow projects to move forward while removing the obstacles and toxins that result in setbacks. That is easily said, but for most managers it will require a new perspective and new behaviors. A simple checklist, consulted daily, can help make those habitual.

intrinsic interest in the work; how positively they view their organization, their management, their team, their work, and themselves—all these combine either to push them to higher levels of achievement or to drag them down.

To understand such interior dynamics better, we asked members of project teams to respond individually to an end-of-day e-mail survey during the course of the project—just over four months, on average. (For more on this research, see our article "Inner Work Life: Understanding the Subtext of Business Performance," HBR May 2007.) The projects—inventing kitchen gadgets, managing product lines of cleaning tools, and solving complex IT problems for a hotel empire, for example—all involved creativity. The daily survey inquired about participants' emotions and moods, motivation levels, and perceptions of the work environment that day, as well as what work they did and what events stood out in their minds.

Twenty-six project teams from seven companies participated, comprising 238 individuals. This yielded nearly 12,000 diary entries. Naturally, every individual in our population experienced ups and downs. Our goal was to discover the states of inner work life and the workday events that correlated with the highest levels of creative output.

In a dramatic rebuttal to the commonplace claim that high pressure and fear spur achievement, we found that, at least in the realm of knowledge work, people are more creative and productive when their inner work lives are positive—when they feel happy, are intrinsically motivated by the work itself, and have positive perceptions of their colleagues and the organization. Moreover, in those positive states, people are more committed to the work and more collegial toward those around them. Inner work life, we saw, can fluctuate from one day to the next—sometimes wildly—and performance along with it. A person's inner work life on a given day fuels his or her performance for the day and can even affect performance the *next* day.

Once this *inner work life effect* became clear, our inquiry turned to whether and how managerial action could set it in motion. What events could evoke positive or negative emotions, motivations, and perceptions? The answers were tucked within our research participants' diary entries. There are predictable triggers that inflate or deflate inner work life, and, even accounting for variation among individuals, they are pretty much the same for everyone.

The Power of Progress

Our hunt for inner work life triggers led us to the progress principle. When we compared our research participants' best and worst days (based on their overall mood, specific emotions, and motivation levels), we found that the most common event triggering a "best day" was any progress in the work by the individual or the team. The most common event triggering a "worst day" was a setback.

Consider, for example, how progress relates to one component of inner work life: overall mood ratings. Steps forward occurred on 76% of people's best-mood days. By contrast, setbacks occurred on only 13% of those days. (See the exhibit "What Happens on a Good Day?")

Two other types of inner work life triggers also occur frequently on best days: *Catalysts,* actions that directly support work, including help from a person or group, and *nourishers,* events such as shows of respect and words of encouragement. Each has an opposite: *Inhibitors,* actions that fail to support or actively hinder work, and *toxins,* discouraging or undermining events. Whereas catalysts and inhibitors are directed at the project, nourishers and toxins are directed at the person. Like setbacks, inhibitors and toxins are rare on days of great inner work life.



About the Spotlight Artist

Each month we illustrate our Spotlight package with a series of works from an accomplished artist. We hope that the lively and cerebral creations of these photographers, painters, and installation artists will infuse our pages with additional energy and intelligence and amplify what are often complex and abstract concepts.

This month the Spotlight artist is **Xavier Veilhan,** whose work focuses on his interest in mechanical systems and technical progress, including reconstructions, by hand, of an original Ford Model T, bicycles, a motor scooter, and a Swiss cuckoo clock.

View more of the artist's work at **veilhan.net**.

A Surprise for Managers

In a 1968 issue of HBR, Frederick Herzberg published a now-classic article titled "One More Time: How Do You Motivate Employees?" Our findings are consistent with his message: People are most satisfied with their jobs (and therefore most motivated) when those jobs give them the opportunity to experience achievement.

The diary research we describe in this article—in which we microscopically examined the events of thousands of workdays, in real time—uncovered the mechanism underlying the sense of achievement: making consistent, meaningful progress.

But managers seem not to have taken Herzberg's lesson to heart. To assess contemporary awareness of the importance of daily work progress, we recently administered a survey to 669 managers of varying levels from dozens of companies around the world. We asked about the managerial tools that can affect employees' motivation and emotions. The respondents ranked five tools—support for making progress in the work, recognition for good work, incentives, interpersonal support, and clear goals—in order of importance.

Fully 95% of the managers who took our survey would probably be surprised to learn that supporting progress is the primary way to elevate motivation—because that's the percentage that failed to rank progress number one. In fact, only 35 managers ranked progress as the number one motivator—a mere 5%. The vast majority of respondents ranked support for making progress dead last as a motivator and third as an influence on emotion. They ranked "recognition for good work (either public or private)" as the most important factor in motivating workers and making them happy. In our diary study, recognition certainly did boost inner work life. But it wasn't nearly as prominent as progress. Besides, without work achievements, there is little to recognize.

Events on worst-mood days are nearly the mirror image of those on best-mood days (see the exhibit "What Happens on a Bad Day?"). Here, setbacks predominated, occurring on 67% of those days; progress occurred on only 25% of them. Inhibitors and toxins also marked many worst-mood days, and catalysts and nourishers were rare.

This is the progress principle made visible: If a person is motivated and happy at the end of the workday, it's a good bet that he or she made some progress. If the person drags out of the office disengaged and joyless, a setback is most likely to blame.

When we analyzed all 12,000 daily surveys filled out by our participants, we discovered that progress and setbacks influence all three aspects of inner work life. On days when they made progress, our participants reported more positive *emotions*. They not only were in a more upbeat mood in general but also expressed more joy, warmth, and pride. When they suffered setbacks, they experienced more frustration, fear, and sadness.

Motivations were also affected: On progress days, people were more intrinsically motivated—by interest in and enjoyment of the work itself. On setback days, they were not only less intrinsically motivated but also less extrinsically motivated by recognition. Apparently, setbacks can lead a person to feel generally apathetic and disinclined to do the work at all.

Perceptions differed in many ways, too. On progress days, people perceived significantly more positive challenge in their work. They saw their teams as more mutually supportive and reported more positive interactions between the teams and their supervisors. On a number of dimensions, perceptions suffered when people encountered setbacks. They found less positive challenge in the work, felt that they had less freedom in carrying it out, and reported that they had insufficient resources. On setback days, participants perceived both their teams and their supervisors as less supportive.

To be sure, our analyses establish correlations but do not prove causality. Were these changes in inner work life the result of progress and setbacks, or was the effect the other way around? The numbers alone cannot answer that. However, we do know, from reading thousands of diary entries, that more-positive perceptions, a sense of accomplishment, satisfaction, happiness, and even elation often followed progress. Here's a typical post-progress entry, from a programmer: "I smashed that bug that's been frustrating me for almost a calendar week. That may not be an event to you, but I live a very drab life, so I'm all hyped."

Likewise, we saw that deteriorating perceptions, frustration, sadness, and even disgust often followed setbacks. As another participant, a product marketer, wrote, "We spent a lot of time updating the Cost Reduction project list, and after tallying all the numbers, we are still coming up short of our goal. It is discouraging to not be able to hit it after all the time spent and hard work."

Almost certainly, the causality goes both ways, and managers can use this feedback loop between progress and inner work life to support both.

Minor Milestones

When we think about progress, we often imagine how good it feels to achieve a long-term goal or experience a major breakthrough. These big wins are great—but they are relatively rare. The good news



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is that even small wins can boost inner work life tremendously. Many of the progress events our research participants reported represented only minor steps forward. Yet they often evoked outsize positive reactions. Consider this diary entry from a programmer in a high-tech company, which was accompanied by very positive self-ratings of her emotions, motivations, and perceptions that day: "I figured out why something was not working correctly. I felt relieved and happy because this was a minor milestone for me."

Even ordinary, incremental progress can increase people's engagement in the work and their happiness during the workday. Across all types of events our participants reported, a notable proportion (28%) of incidents that had a minor impact on the project had a major impact on people's feelings about it. Because inner work life has such a potent effect on creativity and productivity, and because small but consistent steps forward, shared by many people, can accumulate into excellent execution, progress events that often go unnoticed are critical to the overall performance of organizations.

Unfortunately, there is a flip side. Small losses or setbacks can have an extremely negative effect on inner work life. In fact, our study and research by others show that negative events can have a more powerful impact than positive ones. Consequently, it is especially important for managers to minimize daily hassles.

Progress in Meaningful Work

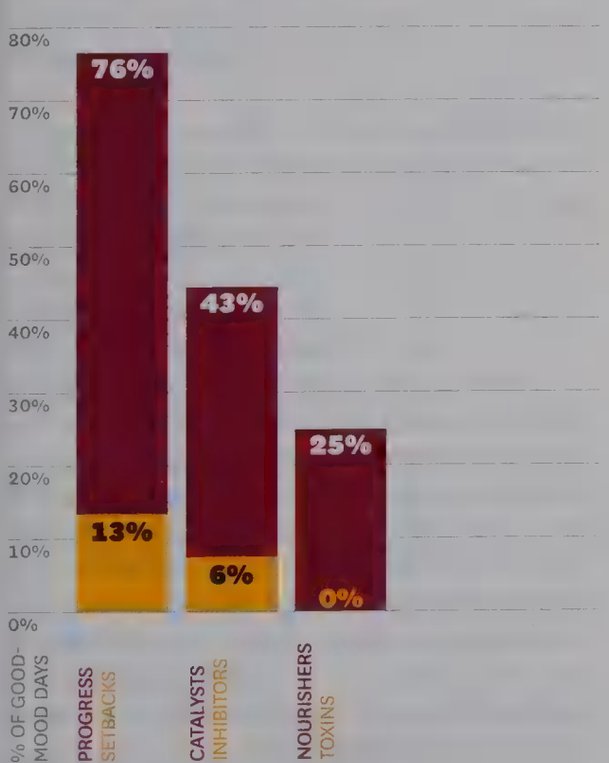
We've shown how gratifying it is for workers when they are able to chip away at a goal, but recall what we said earlier: The key to motivating performance is supporting progress in *meaningful* work. Making headway boosts your inner work life, but only if the work matters to you.

Think of the most boring job you've ever had. Many people nominate their first job as a teenager—washing pots and pans in a restaurant kitchen, for example, or checking coats at a museum. In jobs like those, the power of progress seems elusive. No matter how hard you work, there are always more pots to wash and coats to check; only punching the time clock at the end of the day or getting the paycheck at the end of the week yields a sense of accomplishment.

In jobs with much more challenge and room for creativity, like the ones our research participants had,

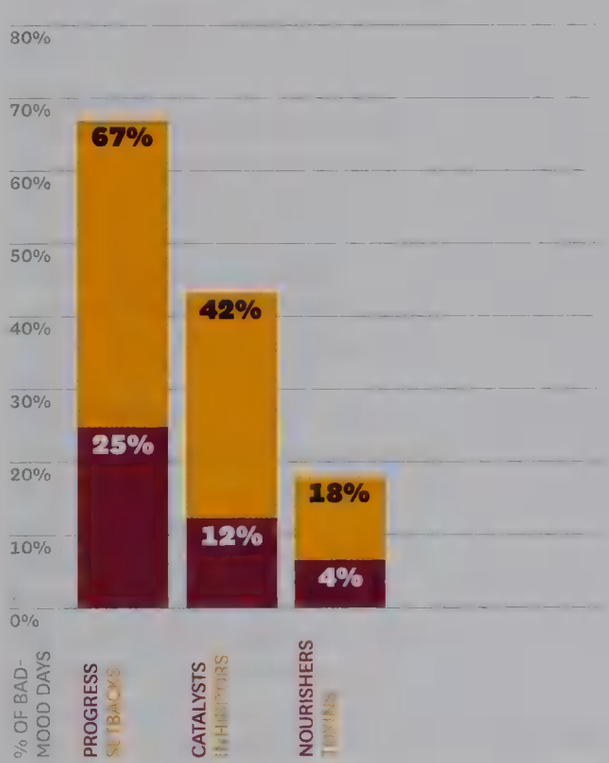
WHAT HAPPENS ON A GOOD DAY?

Progress—even a small step forward—occurs on many of the days people report being in a good mood.



WHAT HAPPENS ON A BAD DAY?

Events on bad days—setbacks and other hindrances—are nearly the mirror image of those on good days.



simply "making progress"—getting tasks done—doesn't guarantee a good inner work life, either. You may have experienced this rude fact in your own job, on days (or in projects) when you felt demotivated, devalued, and frustrated, even though you worked hard and got things done. The likely cause is your perception of the completed tasks as peripheral or irrelevant. For the progress principle to operate, the work must be meaningful to the person doing it.

In 1983, Steve Jobs was trying to entice John Sculley to leave a wildly successful career at PepsiCo to become Apple's new CEO. Jobs reportedly asked him, "Do you want to spend the rest of your life selling sugared water or do you want a chance to change the world?" In making his pitch, Jobs leveraged a potent psychological force: the deep-seated human desire to do meaningful work.

Fortunately, to feel meaningful, work doesn't have to involve putting the first personal computers in the hands of ordinary people, or alleviating poverty, or helping to cure cancer. Work with less profound importance to society can matter if it contributes value to something or someone important to the worker. Meaning can be as simple as making a useful and high-quality product for a customer or providing a genuine service for a community. It can be supporting a colleague or boosting an organization's profits by reducing inefficiencies in a production process. Whether the goals are lofty or modest, as long as they are meaningful to the worker and it is clear how his or her efforts contribute to them, progress toward them can galvanize inner work life.

In principle, managers shouldn't have to go to extraordinary lengths to infuse jobs with meaning. Most jobs in modern organizations are potentially meaningful for the people doing them. However, managers can make sure that employees know just how their work is contributing. And, most important, they can avoid actions that negate its value. (See the sidebar "How Work Gets Stripped of Its Meaning.") All the participants in our research were doing work that should have been meaningful; no one was washing pots or checking coats. Shockingly often, however, we saw potentially important, challenging work losing its power to inspire.

Supporting Progress: Catalysts and Nourishers

What can managers do to ensure that people are motivated, committed, and happy? How can they support workers' daily progress? They can use catalysts and nourishers, the other kinds of frequent "best day" events we discovered.

Catalysts are actions that support work. They include setting clear goals, allowing autonomy, providing sufficient resources and time, helping with the work, openly learning from problems and successes, and allowing a free exchange of ideas. Their opposites, inhibitors, include failing to provide support and actively interfering with the work. Because of their impact on progress, catalysts and inhibitors ultimately affect inner work life. But they also have a more immediate impact: When people realize that they have clear and meaningful goals, sufficient resources, helpful colleagues, and so on, they get an instant boost to their emotions, their motivation to do a great job, and their perceptions of the work and the organization.

Managers can help employees see how their work is contributing. Most important, they can avoid actions that negate its value.

Nourishers are acts of interpersonal support, such as respect and recognition, encouragement, emotional comfort, and opportunities for affiliation. Toxins, their opposites, include disrespect, discouragement, disregard for emotions, and interpersonal conflict. For good and for ill, nourishers and toxins affect inner work life directly and immediately.

Catalysts and nourishers—and their opposites—can alter the meaningfulness of work by shifting people's perceptions of their jobs and even themselves. For instance, when a manager makes sure that people have the resources they need, it signals to them that what they are doing is important and valuable. When managers recognize people for the work they do, it signals that they are important to the organization. In this way, catalysts and nourishers can lend greater meaning to the work—and amplify the operation of the progress principle.

The managerial actions that constitute catalysts and nourishers are not particularly mysterious; they may sound like Management 101, if not just common sense and common decency. But our diary study reminded us how often they are ignored or forgotten. Even some of the more attentive managers in the companies we studied did not consistently provide catalysts and nourishers. For example, a supply-chain specialist named Michael was, in many ways and on most days, an excellent subteam manager. But he was occasionally so overwhelmed that he became toxic toward his people. When a supplier failed to complete a "hot" order on time and Michael's team had to resort to air shipping to meet the customer's deadline, he realized that the profit margin on the sale would be blown. In irritation, he lashed out at his subordinates, demeaning the solid work they had done and disregarding their own frustration with the supplier. In his diary, he admitted as much:

As of Friday, we have spent $28,000 in air freight to send 1,500 $30 spray jet mops to our number two customer. Another 2,800 remain on this order, and there is a good probability that they too will gain wings. I have turned from the kindly Supply Chain Manager into the black-masked executioner. All similarity to civility is gone, our backs are against the wall, flight is not possible, therefore fight is probable.

Even when managers don't have their backs against the wall, developing long-term strategy and launching new initiatives can often seem more important—and perhaps sexier—than making sure that subordinates have what they need to make steady progress and feel supported as human beings. But as we saw repeatedly in our research, even the best strategy will fail if managers ignore the people working in the trenches to execute it.

A Model Manager—And a Tool for Emulating Him

We could explain the many (and largely unsurprising) moves that can catalyze progress and nourish spirits, but it may be more useful to give an example of a manager who consistently used those moves—and then to provide a simple tool that can help any manager do so.

Our model manager is Graham, whom we observed leading a small team of chemical engineers within a multinational European firm we'll call Kruger-Bern. The mission of the team's NewPoly project was clear and meaningful enough: develop

How Work Gets Stripped of Its Meaning

Diary entries from 238 knowledge workers who were members of creative project teams revealed

4 primary ways in which managers unwittingly drain work of its meaning.

ONE Managers may dismiss the importance of employees' work or ideas. Consider the case of Richard, a senior lab technician at a chemical company, who found meaning in helping his new-product development team solve complex technical problems. However, in team meetings over the course of a three-week period, Richard perceived that his team leader was ignoring his suggestions and those of his teammates. As a result, he felt that his contributions were not meaningful, and his spirits flagged. When at last he believed that he was again making a substantive contribution to the success of the project, his mood improved dramatically:

I felt much better at today's team meeting. I felt that my opinions and information were important to the project and that we have made some progress.

TWO They may destroy employees' sense of ownership of their work. Frequent and abrupt reassignments often have this effect. This happened repeatedly to the members of a product development team in a giant consumer products company, as described by team member Bruce:

As I've been handing over some projects, I do realize that I don't like to give them up. Especially when you have been with them from the start and are nearly to the end. You lose ownership. This happens to us way too often.

THREE Managers may send the message that the work employees are doing will never see the light of day. They can signal this—unintentionally—by shifting their priorities or changing their minds about how something should be done. We saw the latter in an internet technology company after user-interface developer Burt had spent weeks designing seamless transitions for non-English-speaking users. Not surprisingly, Burt's mood was seriously marred on the day he reported this incident:

Other options for the international [interfaces] were [given] to the team during a team meeting, which could render the work I am doing useless.

FOUR They may neglect to inform employees about unexpected changes in a customer's priorities. Often, this arises from poor customer management or inadequate communication within the company. For example, Stuart, a data transformation expert at an IT company, reported deep frustration and low motivation on the day he learned that weeks of the team's hard work might have been for naught:

Found out that there is a strong possibility that the project may not be going forward, due to a shift in the client's agenda. Therefore, there is a strong possibility that all the time and effort put into the project was a waste of our time.

The Daily Progress Checklist

Near the end of each workday, use this checklist to review the day and plan your managerial actions for the next day. After a few days, you will be able to identify issues by scanning the boldface words. First, focus on progress and setbacks and think about specific events (catalysts, nourishers, inhibitors, and toxins) that contributed to them. Next, consider any clear inner-work-life clues and what further information they provide about progress and other events. Finally, prioritize for action. The action plan for the next day is the most important part of your daily review: What is the one thing you can do to best facilitate progress?

Progress

Which 1 or 2 events today indicated either a small win or a possible breakthrough? (Describe briefly.)

Setbacks

Which 1 or 2 events today indicated either a small setback or a possible crisis? (Describe briefly.)

CATALYSTS

- ☐ Did the team have clear short- and long-term **goals** for meaningful work?
- ☐ Did team members have sufficient **autonomy** to solve problems and take ownership of the project?
- ☐ Did they have all the **resources** they needed to move forward efficiently?
- ☐ Did they have sufficient **time** to focus on meaningful work?
- ☐ Did I give or get them **help** when they needed or requested it? Did I encourage team members to help one another?
- ☐ Did I discuss **lessons** from today's successes and problems with my team?
- ☐ Did I help **ideas** flow freely within the group?

INHIBITORS

- ☐ Was there any confusion regarding long- or short-term **goals** for meaningful work?
- ☐ Were team members overly **constrained** in their ability to solve problems and feel ownership of the project?
- ☐ Did they lack any of the **resources** they needed to move forward effectively?
- ☐ Did they lack sufficient **time** to focus on meaningful work?
- ☐ Did I or others fail to provide needed or requested **help**?
- ☐ Did I "punish" failure or neglect to find **lessons** and/or opportunities in problems and successes?
- ☐ Did I or others cut off the presentation or debate of **ideas** prematurely?

NOURISHERS

- ☐ Did I show **respect** to team members by recognizing their contributions to progress, attending to their ideas, and treating them as trusted professionals?
- ☐ Did I **encourage** team members who faced difficult challenges?
- ☐ Did I **support** team members who had a personal or professional problem?
- ☐ Is there a sense of personal and professional **affiliation** and camaraderie within the team?

TOXINS

- ☐ Did I **disrespect** any team members by failing to recognize their contributions to progress, not attending to their ideas, or not treating them as trusted professionals?
- ☐ Did I **discourage** a member of the team in any way?
- ☐ Did I **neglect** a team member who had a personal or professional problem?
- ☐ Is there tension or **antagonism** among members of the team or between team members and me?

INNER WORK LIFE

Did I see any indications of the quality of my subordinates' inner work lives today? _____

Perceptions of the work, team, management, firm _____

Emotions _____

Motivation _____

What specific events might have affected inner work life today? _____

ACTION PLAN

What can I do tomorrow to strengthen the catalysts and nourishers identified and provide the ones that are lacking?

What can I do tomorrow to start eliminating the inhibitors and toxins identified?

Effective managers establish themselves as resources, making sure to *check in* on employees while never seeming to *check up* on them.

a safe, biodegradable polymer to replace petrochemicals in cosmetics and, eventually, in a wide range of consumer products. As in many large firms, however, the project was nested in a confusing and sometimes threatening corporate setting of shifting top-management priorities, conflicting signals, and wavering commitments. Resources were uncomfortably tight, and uncertainty loomed over the project's future—and every team member's career. Even worse, an incident early in the project, in which an important customer reacted angrily to a sample, left the team reeling. Yet Graham was able to sustain team members' inner work lives by repeatedly and visibly removing obstacles, materially supporting progress, and emotionally supporting the team.

Graham's management approach excelled in four ways. First, he established a positive climate, one event at a time, which set behavioral norms for the entire team. When the customer complaint stopped the project in its tracks, for example, he engaged immediately with the team to analyze the problem, without recriminations, and develop a plan for repairing the relationship. In doing so, he modeled how to respond to crises in the work: not by panicking or pointing fingers but by identifying problems and their causes, and developing a coordinated action plan. This is both a practical approach and a great way to give subordinates a sense of forward movement even in the face of the missteps and failures inherent in any complex project.

Second, Graham stayed attuned to his team's everyday activities and progress. In fact, the nonjudgmental climate he had established made this happen naturally. Team members updated him frequently—without being asked—on their setbacks, progress, and plans. At one point, one of his hardest-working colleagues, Brady, had to abort a trial of a new material because he couldn't get the parameters right on the equipment. It was bad news, because the NewPoly team had access to the equipment only one day a week, but Brady immediately informed Graham. In his diary entry that evening, Brady noted, "He didn't like the lost week but seemed to understand." That understanding assured Graham's place in the stream of information that would allow him to give his people just what they needed to make progress.

Third, Graham targeted his support according to recent events in the team and the project. Each day, he could anticipate what type of intervention—a catalyst or the removal of an inhibitor; a nourisher or some antidote to a toxin—would have the most impact on team members' inner work lives and progress. And if he could not make that judgment, he asked. Most days it was not hard to figure out, as on the day he received some uplifting news about his bosses' commitment to the project. He knew the team was jittery about a rumored corporate reorganization and could use the encouragement. Even though the clarification came during a well-earned vacation day, he immediately got on the phone to relay the good news to the team.

Finally, Graham established himself as a resource for team members, rather than a micromanager; he was sure to *check in* while never seeming to *check up* on them. Superficially, checking in and checking up seem quite similar, but micromanagers make four kinds of mistakes. First, they fail to allow autonomy in carrying out the work. Unlike Graham, who gave the NewPoly team a clear strategic goal but respected members' ideas about how to meet it, micromanagers dictate every move. Second, they frequently ask subordinates about their work without providing any real help. By contrast, when one of Graham's team members reported problems, Graham helped analyze them—remaining open to alternative interpretations—and often ended up helping to get things back on track. Third, micromanagers are quick to affix personal blame when problems arise, leading subordinates to hide problems rather than honestly discuss how to surmount them, as Graham did with Brady. And fourth, micromanagers tend to hoard information to use as a secret weapon. Few realize how damaging this is to inner work life. When subordinates perceive that a manager is withholding potentially useful information, they feel infantilized, their motivation wanes, and their work is handicapped. Graham was quick to communicate upper management's views of the project, customers' opinions and

By supporting progress in meaningful work, managers improve employees' inner work lives and the organization's performance.

needs, and possible sources of assistance or resistance within and outside the organization.

In all those ways, Graham sustained his team's positive emotions, intrinsic motivation, and favorable perceptions. His actions serve as a powerful example of how managers at any level can approach each day determined to foster progress.

We know that many managers, however well-intentioned, will find it hard to establish the habits that seemed to come so naturally to Graham. Awareness, of course, is the first step. However, turning an awareness of the importance of inner work life into routine action takes discipline. With that in mind, we developed a checklist for managers to consult on a daily basis (see the exhibit "The Daily Progress Checklist"). The aim of the checklist is managing for meaningful progress, one day at a time.

The Progress Loop

Inner work life drives performance; in turn, good performance, which depends on consistent progress, enhances inner work life. We call this the *progress loop;* it reveals the potential for self-reinforcing benefits.

So, the most important implication of the progress principle is this: By supporting people and their daily progress in meaningful work, managers improve not only the inner work lives of their employees but also the organization's long-term performance, which enhances inner work life even more. Of course, there is a dark side—the possibility of negative feedback loops. If managers fail to support progress and the people trying to make it, inner work life suffers and so does performance; and degraded performance further undermines inner work life.

A second implication of the progress principle is that managers needn't fret about trying to read the psyches of their workers, or manipulate complicated incentive schemes, to ensure that employees are motivated and happy. As long as they show basic respect and consideration, they can focus on supporting the work itself.

To become an effective manager, you must learn to set this positive feedback loop in motion. That may require a significant shift. Business schools, business books, and managers themselves usually focus on managing organizations or people. But if you focus on managing progress, the management of people—and even of entire organizations—becomes much more feasible. You won't have to figure out how to x-ray the inner work lives of subordinates; if you facilitate their steady progress in meaningful work, make that progress salient to them, and treat them well, they will experience the emotions, motivations, and perceptions necessary for great performance. Their superior work will contribute to organizational success. And here's the beauty of it: They will love their jobs.

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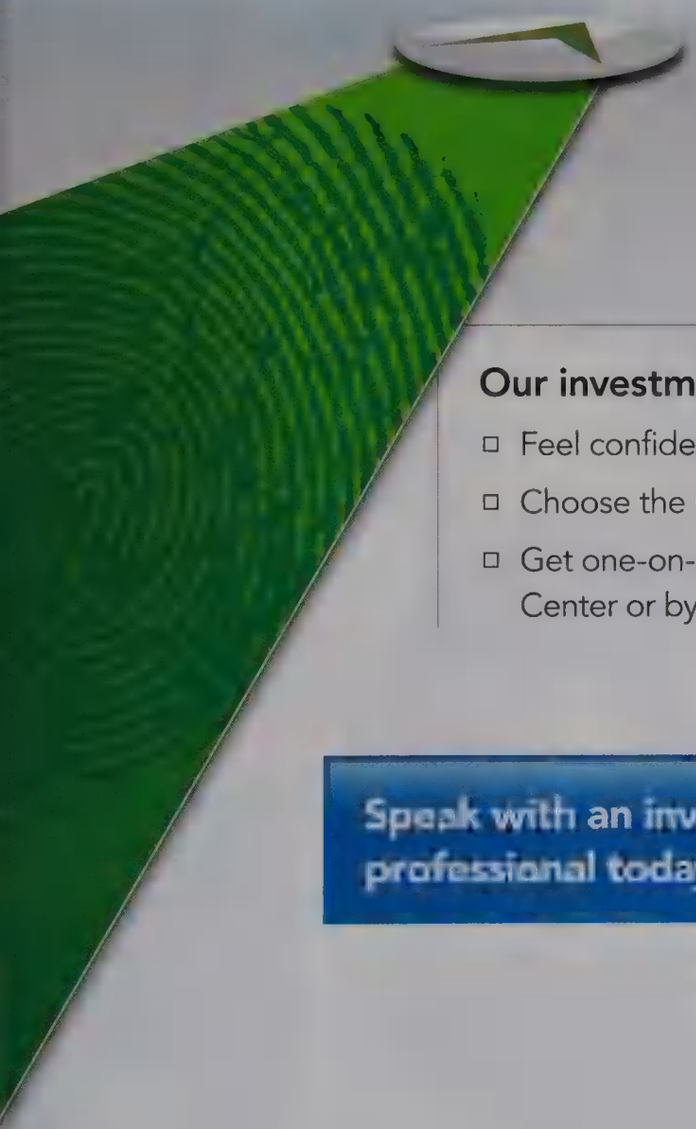
"We save money on job recruitment this way."



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Spotlight

ARTWORK Xavier Veilhan, *The Cuckoo*, detail, 2005
Aluminium, steel, epoxy paint, 7.75' x 17.5' x 1.25'
Exhibition view, *Le Plein emploi*, MAMC, Strasbourg





Being More Productive

Is the secret to effectiveness the right system or the right state of mind? Two leading experts weigh in.

DAVID ALLEN AND TONY SCHWARTZ knew of each other's work for years, but they'd never met. Allen is a productivity consultant and the author of the best seller *Getting Things Done*, which outlines the list-driven efficiency system adherents call by its acronym: GTD. Schwartz, the author of the best seller *Be Excellent at Anything* and a regular HBR blogger, is the CEO of The Energy Project, which helps people and organizations fuel engagement and productivity by drawing on the science of high performance.

The two men have consulted for many of the same companies, sometimes giving seminars in the same auditoriums on back-to-back days. Then last summer Allen dropped in on a presentation that Schwartz was giving at a trade show. In the months since, they've gotten together several times to talk about their approaches to improving the performance of knowledge workers. In this edited conversation with HBR, they discuss the distractive pull of e-mail, how they've been influenced by each other, and why you should do your most important task first thing in the morning (even though only one of them does).



CONNECT WITH THE AUTHORS Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

HBR: Let's start with something simple. How does each of you define what you do?

ALLEN: I help people and organizations produce more with less input. I teach a set of best practices and a methodology that produce a greater sense of concentration and control.

SCHWARTZ: We teach individuals and organizations how to manage energy more skillfully in order to get more work done in less time, more sustainably. That requires a new way of working—one that balances periods of high focus with intermittent renewal.

Both of you have written several books describing your techniques, but give me a quick summary.

ALLEN: I call what I've uncovered "the strategic value of clear space." Say you're going to cook dinner for people, it's 5:00 PM, and they're coming at 6:00. You want to have all the right ingredients. You want to have the right tools. You want the kitchen to be nice and clear. You need the freedom to make a creative mess. I teach people to achieve that freedom by taking very immediate, concrete steps: downloading all your commitments and projects into lists, focusing on "next actions," and thinking about the context—work that needs to be done in your office, or on the phone, or on the computer. You don't need to change who you are. You just need some simple but very powerful techniques.

SCHWARTZ: We focus on the four primary dimensions of energy that we all need to perform at our best. The ground level is physical—fitness, sleep, nutrition, and rest. At the emotional level, it's about cultivating positive emotions—and as a leader, communicating them to others. At the mental level, it's about gaining more control of your attention—both by increasing the ability to focus on one thing at a time and by learning to shift into the right hemisphere to do more-creative work. And at the spiritual level, it's about defining purpose, because when something really matters, you bring far more energy to it. Very few C-suite leaders I've met fully appreciate how meeting these needs—in themselves and for others—is absolutely critical to sustainable high performance. They're good at doing things, and they've been rewarded by being given more things to do. But increasingly demand is outrunning their capacity. They're overloaded by e-mail and texts and all the information that comes in. We have to teach them to step back and say, "What do I actually want to do? What are the right choices? What are the costs of this choice?"

Let's talk about some of the concrete principles you teach. Tony, explain why you think people should approach work as a series of short sprints, not an all-day marathon.

SCHWARTZ: There's a fundamental misunderstanding about how human beings operate at their best. Most of us mistakenly assume we're meant to run like computers—at high speeds, continuously, for long periods of time, running multiple programs simultaneously. It's just not true. Human beings are designed to be rhythmic. The heart pulses; muscles contract and relax. We're at our best when we're moving rhythmically between spending energy and renewing it. We need to recognize the insight of athletes, who manage their work-rest ratios. We encourage people to work intensely for 90 minutes and then take a break to recover. We teach them to eat small, energy-rich meals every few hours, rather than three big meals a day. We believe napping drives productivity, although that remains a tough sell in most companies. Still, the reality is that if a person works continuously all through the day, she'll produce less than a person of equal talent who works very intensely for short periods and then recovers before working intensely again.

ALLEN: It's also an issue of choosing the right work. Peter Drucker said that the toughest job for knowledge workers is defining the work. A century ago, 80% of the world made and moved things. You worked as long as you could, and then you slept, and then you got up and worked again. You didn't have to triage or make executive decisions. It's harder to be productive today because the work has become much more complex.

Tony, you've also written about how the cultures of some organizations encourage people to work in ways that are unhealthful and ultimately limit productivity. Why do companies do that?

SCHWARTZ: I remember giving a talk at a prestigious investment bank several years ago. At the end a partner stood up and said, "Mr. Schwartz, this is all very interesting, but we have a thousand people knocking on the door who can't wait to come in and replace the people we've burned out. Why should we worry about giving people time to renew? When they burn out, we just bring in a fresh new group of



"We encourage people to work intensely for 90 minutes and then take a break. We believe napping drives productivity."
TONY SCHWARTZ

people, who are thrilled to get the jobs." I'd argue that in knowledge work, you get more out of a person in the third or fifth or seventh year than out of the replacement you brought in because the first worker collapsed in year two. This is a broader issue that deserves attention. We can't keep pushing people to their limits and expect them to produce at a sustainably high level of excellence. The companies that build true competitive advantage in the years ahead will be those that shift from seeking to get more out of people to investing in better meeting their needs.

David, what's the biggest roadblock to productivity that you typically observe when you go into an organization for the first time?

ALLEN: People don't capture stuff that has their attention. They don't acknowledge it or objectify it. And it keeps rolling around in the organizational psyche as well as the personal psyche, draining energy and creating incredible psychic residue. People say, "I'll do that," but they don't write it down, and it goes into a black hole. That would be fine if it were just one thing, but it's hundreds of things. And people don't determine exactly what their commitment to that stuff is—what's the outcome they want to achieve, what's the next action required to move it forward. Your head is for having ideas, not holding them. Just dumping everything out of your head and externalizing it is a huge step, and it can have a significant effect.

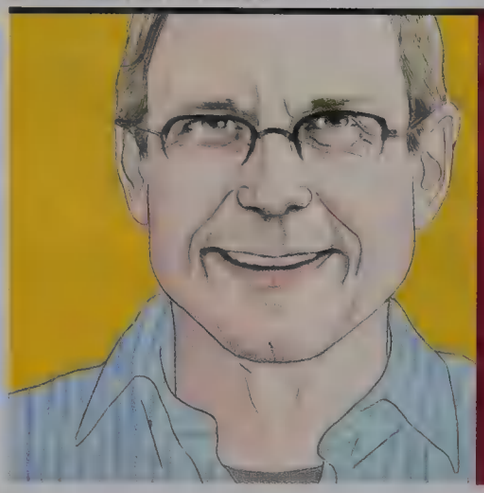
The devil's advocate position is that this results in gigantic to-do lists, which are overwhelming in themselves.

ALLEN: People do look at all my lists and say, "God, you've got too many." But if you don't think lists are the way to go, throw away your calendar. Don't be intellectually dishonest about it. Why do you have a calendar? Because the world started to become a little more complex, and therefore you need help managing creative energy that can't be closed up or finished. You need lists because your brain isn't good at keeping them. Your mind is this dumb little computer that will wake you up at 3:00 AM and beat you bloody over stuff you can't do spit about while you're lying there. All it's doing is repeating stuff in open loops, and it sucks your energy like crazy.

SCHWARTZ: There's a process of humility that's required here. It's a little bit of a turn on the 12-step notion of admitting that you're powerless over your addictions. In this case, the addiction is to e-mail and information. The problem is that our willpower and self-discipline are wildly overrated. We think the way to make a change is to push harder—to resist that chocolate chip cookie, or wake up early and get to the gym. It doesn't work. It's humbling to discover that we're creatures of habit, and what we did yesterday is what we're going to do today. You want to co-opt the process by which negative habits arise without your intention, and substitute what we call "positive rituals," or deliberate practices.

How much do you know about each other's work—and how much do you use each other's strategies?

SCHWARTZ: I always kept lists, but until I connected with David's work, I didn't realize that anything I didn't download would potentially create distractions—so now I keep lists of *everything.* Another ritual I have that aligns with David's work is to always do the most important task of the day first thing in the morning, when I'm most rested and least distracted. Ninety percent of people check their e-mail as soon as they get to work. That turns their agenda over to someone else. They do it because it's easy—you can feel more effective in a shorter time by answering e-mails. It also feels good to be wanted, and e-mails affirm that people want you. Human beings are designed to do two fundamental things: avoid pain and move toward pleasure. One instinct kept us alive; the other allowed us to reproduce. Those are still the impulses that drive us. You need a higher part of the brain to be able to step back and say, "There's a better choice to be made here."



"Your head is for having ideas, not holding them. Dumping everything out into a list can have a significant effect."

DAVID ALLEN

Tony, there's one test that separates GTD dabblers from true devotees: Do you have a label maker?

SCHWARTZ: No. But you know what? I'm early in my career with GTD, so I don't feel bad.

David, how has Tony's thinking influenced the way you work?

ALLEN: The piece that's made the biggest difference is his work on energy cycles. I actually brought a pillow into work. I work in a glass office, and now people can see me lying on my floor taking a nap for 20 minutes. That's directly from Tony's work. I wish I had the discipline Tony does to tackle the hardest tasks first thing in the morning, but I don't.

SCHWARTZ: It's not that you don't have the discipline—it's that you don't have the ritual. If you built that ritual, I have zero doubt that you could do it. There's a problem with making a decision based on how you're feeling at any given moment. Generally speaking, that doesn't work. Psychologically we have two different selves. One is very primitive and reactive. The other is more evolved and reflective. People need to recognize when the primitive, reactive self is taking over and influencing them to avoid things that are uncomfortable. You can't wait to do things until the spirit moves you.

ALLEN: Part of the way to attack that problem is to break big tasks down and focus on smaller "next actions," which can seem more manageable. What most people put on a to-do list are vague things like "Mom." Great! So Tony will write down "Mom," signifying that he has to decide whether to get his mother a birthday present, and what to buy, and how to deliver it. He'll resist looking at the list, because he knows there's a lot of work in that simple notation. Instead the list should specify a smaller next action—say, "Call sister re Mom's birthday." Oh, look—I can do that! There's actually a part of us that loves to produce, that loves to be complete. Now I've created motivation: I see a desired result, I have the confidence I can get there, and I see the path. A lot of what GTD does is set it up so that you only have to think about things once. The problem is that everybody is multitasking and getting distracted by the latest and loudest. They fail because they haven't captured, clarified, organized, or built in a regular review system they trust.

SCHWARTZ: Let me beg to differ a little. Say you're working on a primary task and you get an e-mail. You hear that little Pavlovian beep, and you cannot resist it. So you turn to the e-mail and lose track of the initial task, and it takes you time to reconnect to it afterward. Researchers have found that over time and with practice, people get better at task shifting, but they never get remotely as good as they'd be if they did one thing at a time.

ALLEN: Let's take it a step further. Why do people get disturbed by that e-mail beep? It's because they don't trust that they've emptied their e-mail every 24 hours. Most people are living in an emergency scan mode. They never deal with their e-mail, so they're afraid there's still something sitting in there, and they're constantly allowing themselves to get distracted by it.

SCHWARTZ: Before the next question—how long have we been talking?

ALLEN: Eighty-five minutes.

SCHWARTZ: Can we pause for a moment? I'm thirsty, and my mind is starting to be less than 100% here. I've built this 90-minute cycle into my body, and it's gotten very good at saying to me, "Give me a break."

[After a 10-minute break] What role do leaders play in making workers more productive?

SCHWARTZ: The leader's role is to be the chief energy officer. It's to mobilize and focus and direct and inspire and regularly recharge those he or she leads.

ALLEN: If bosses don't appropriately manage the tasks for which people are coming to work, it's impossible for employees to get the bandwidth to do what Tony is talking about. If jobs are not clear, if projects are not well defined, if outcomes are not focused on, if action steps and accountabilities and

responsibilities are not allocated, then the leader hasn't done his job.

Can you talk about why organizations fail when attempting to make knowledge workers more productive?

ALLEN: Ironically, the people who are most interested in our work—and for whom it sticks the most—are the people who need it least. What our work does is eliminate drag. Who's most aware of drag? Those who are already the fastest. Formula One race teams spend millions to save a fraction of a second. Many of the companies that embrace our work are already very successful. It's hard for me to point to an organization that truly failed with our work—if you do only a piece of what we teach, it will improve productivity. So there aren't any huge disasters where companies tried our method and failed.

SCHWARTZ: I'm going to be honest: We've had failures. By that I mean an organization will bring us in to work with a group of people, but the group will fail to ignite. Typically these companies are the most conservative, most hidebound places, where unhappiness among employees runs deepest. They're in what we call the survival zone.

ALLEN: Well, if we use Tony's definition, whereby an organization fails to fully take to what we teach, then I'm a total failure, too.

SCHWARTZ: We're finding that more and more companies have an appetite for our work, and it's no longer just the early adopters. For example, financial institutions have been consistently successful in adopting our work. They're not seen as progressive organizations, but they are highly entrepreneurial, and the financial upside for individuals who get more done is so great that all of them behave, to one extent or another, like athletes. Being a better performer has a lot of direct financial upside in that industry. We're also finding takers in the most traditional businesses, because the reality is that nearly everyone is feeling overwhelmed.

Do you have any point of view about the kinds of companies you work with?

SCHWARTZ: I'm certainly happier working with companies that make products that clearly add value in the world. If they're making cigarettes, I'm not eager to help them get more productive at that.

ALLEN: What about Twinkies?

SCHWARTZ: I'm more ambivalent about Twinkies. I've been known to eat a Twinkie myself. A Twinkie here and there won't hurt you. What I do hope is that food companies get more thoughtful about how they package and market their products. I was working with a large food company lately—it doesn't make Twinkies, but it makes Twinkie-like products—and we ended up talking about whether they should be selling smaller packages, because it would be better for customers' health. This was a group of senior executives, and it didn't seem to me that they'd entertained the question before, but I was encouraged that they were willing to discuss it.

David, when you work with a company, how can you tell if your ideas have really taken root?

ALLEN: I can see it when the culture starts to incorporate the principles as expected behaviors and makes them part of the common lexicon. You'll hear people build them into the language: "What's the next action?" "I have three 'waiting for yous' here—can we go over them?" They're writing things down. They're starting meetings by going over what they expect to accomplish. Those rituals can become enculturated.

Last question: If people could take just one thing away from your work, what should it be?

SCHWARTZ: Organizations need to recognize that human beings are basically organisms containing energy. And that energy is either being renewed or being dissipated over time. An organization has to realize that part of its responsibility, whether it wants it or not, is to ensure that people have full tanks of energy. This is one of the big variables that will determine which organizations thrive in the next 10 or 20 years.

ALLEN: Think about it this way: While we've been sitting here talking, stuff has been piling up in our in-boxes and our voice mails. Some of it has the potential to meaningfully shift our priorities. When we turn to this accumulated stuff, we'll need to eliminate old business that is pulling on us, that's taking our attention, and reallocate our resources to these new priorities. You can only do one thing at a time, and you only have so many resources. You either feel OK about sitting here talking to us, or you feel bad about the 9,000 other things you're not doing. Everybody needs a system to make those choices wisely.

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Spotlight



ARTWORK Xavier Veilhan, *Man on the Phone,* 2006
Painted polyester resin, 27.25' x 11' x 7'
Permanent installation, Cité Internationale, Lyon



The Case For Executive Assistants

Why would you pay managers big salaries and then ask them to make their own hotel reservations? *by Melba J. Duncan*

AMONG THE MOST striking details of the corporate era depicted in the AMC series *Mad Men*, along with constant smoking and mid-day drinking, is the army of secretaries who populate Sterling Cooper, the 1960s ad agency featured in the show. The secretary of those days has gone the way of the carbon copy and been replaced by the executive assistant, now typically reserved for senior management. Technologies like e-mail, voice mail, mobile devices, and online calendars have allowed managers at all levels to operate with a greater degree of self-sufficiency. At the same time, companies have faced enormous pressure to cut costs, reduce head count, and flatten organizational structures. As a result, the numbers of assistants at lower corporate levels have dwindled in most corporations. That's unfortunate, because effective assistants can make enormous contributions to productivity at all levels of the organization.

At very senior levels, the return on investment from a skilled assistant can be substantial. Consider a senior executive whose total compensation package is $1 million annually, who works with an assistant who earns $80,000. For the organization to break even, the assistant must make the executive 8% more productive than he or she would be working solo—for instance, the assistant needs to save the executive roughly five hours in a 60-hour workweek. In reality, good assistants save their bosses much more than that. They ensure that meetings begin on time with prep material delivered in advance. They optimize travel schedules and enable remote decision making, keeping projects on track. And they filter the distractions that can turn a manager into a reactive type who spends all day answering e-mail instead of a leader who proactively sets the organization's agenda. As Robert Pozen writes in this issue: A top-notch assistant "is crucial to being productive."

That's true not only for top executives. In their zeal to cut administrative expenses, many companies have gone too far, leaving countless highly paid middle and upper managers to arrange their own travel, file expense reports, and schedule meetings. Some companies may be drawn to the notion of egalitarianism they believe this assistant-less structure represents—when workers see the boss loading paper into the copy machine, the theory goes, a "we're all in this together" spirit is created. But as a management practice, the structure rarely makes economic sense. Generally speaking, work should be delegated to the lowest-cost employee who can do it well. Although companies have embraced this logic by outsourcing work to vendors or to operations abroad, back at headquarters they ignore it, forcing top talent to misuse their time. As a longtime recruiter for executive assistants, I've worked with many organizations suffering from the same problem: There's too much administrative work and too few assistants to whom it can be assigned.

Granting middle managers access to an assistant—or shared resources—can give a quick boost to productivity even at lean, well-run companies. Firms should also think about the broader developmental



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benefits of providing assistants for up-and-coming managers. The real payoff may come when the manager arrives in a job a few levels up better prepared and habitually more productive. An experienced assistant can be particularly helpful if the manager is a new hire. The assistant becomes a crucial onboarding resource, helping the manager read and understand the organizational culture, guiding him or her through its different (and difficult) personalities, and serving as a sounding board during the crucial acclimation. In this way, knowledgeable assistants are more than a productivity asset: They're reverse mentors, using their experience to teach new executives how people are expected to behave at that level in the organization.

Getting the Most from Assistants

Two critical factors determine how well a manager utilizes an assistant. The first is the executive's willingness to delegate pieces of his or her workload to the assistant. The second is the assistant's willingness to stretch beyond his or her comfort zone to assume new responsibilities.

Delegating wisely. The most effective executives think deeply about the pieces of their workload that can be taken on—or restructured to be partially taken on—by the assistant. Triaging and drafting replies to e-mails is a central task for virtually all assistants. Some executives have assistants listen in on phone calls in order to organize and follow up on action items. Today many assistants are taking on more-supervisory roles: They're managing information flow, dealing with basic financial management, attending meetings, and doing more planning and organizing. Executives can help empower their assistants by making it clear to the organization that the assistant has real authority. The message the executive should convey is, "I trust this person to represent me and make decisions."

After years of cutting back, companies can boost productivity by arming more managers with assistants.

Not every executive is well-suited for this type of delegating. Younger managers in particular have grown up with technology that encourages self-sufficiency. Some have become so accustomed to doing their own administrative tasks that they don't communicate well with assistants. These managers should think of assistants as strategic assets and realize that part of their job is managing the relationship to get the highest possible return.

Stretching the limits. Great assistants proactively look for ways to improve their skills. When I was the assistant to Pete Peterson, the former U.S. commerce secretary and head of Lehman Brothers, I took night classes in law, marketing, and presentations to burnish my skills. Today I see executive assistants learning new languages and technologies to improve their performance working for global corporations.

In my work, I frequently encounter world-class executive assistants. Loretta Sophocleous is the executive assistant to Roger Ferguson, the president and CEO of TIAA-CREF; her title is Director, Executive Office Operations. She manages teams. She leads meetings. Roger says that he runs many decisions past Loretta before he weighs in.

Another example is Noreen Denihan, whom I placed over 13 years ago as the executive assistant to Donald J. Gogel, the president and CEO of Clayton, Dubilier & Rice, LLC. According to Don, Noreen fills an informal leadership role, has an unparalleled ability to read complex settings, and can recognize and respond to challenging people and circumstances. "A spectacular executive assistant can defy the laws of the physical world," Gogel says. "She [or he] can see around corners."

Trudy Vitti is the executive assistant to Kevin Roberts, the CEO Worldwide of Saatchi & Saatchi. Often when you ask him a question, he'll say, "Ask Trudy." He travels for weeks at a time and says that he has utter confidence in Trudy to run the office in his absence.

Compared with managers in other countries, those in the United States do a better job of delegating important work to their assistants—and of treating them as a real part of the management team. Outside the United States, educational requirements for assistants are less intensive, salaries are lower, and the role is more typically described as personal assistant.

You can often tell a lot about an executive's management style—and effectiveness—from the way he interacts with his assistant. Can the executive trust and delegate, or does he micromanage? Do assistants like working for her, or does she have a history

Idea in Brief

The average company has gone too far in cutting back on administrative help. Skilled executive assistants can boost productivity, assist in on-boarding new managers, provide reverse mentoring, and act as the air-traffic controller of an office, particularly for managers who travel frequently.

Not every manager makes good use of an assistant. This is a particular problem for younger managers, who've grown up with technology that's increased their self-sufficiency. The two keys to maximizing the value of an assistant are delegating wisely and encouraging the executive assistant to stretch and add responsibilities.

Hiring a good executive assistant can be more difficult than filling other management jobs. Personal chemistry is paramount. The job requires emotional intelligence, good judgment, and capacity for foresight.

of many assistants leaving quickly or being fired? Not every boss-assistant relationship is made in heaven, but an executive's ability to manage conflicts with an assistant can be an important indicator of his overall ability to manage people.

Finding the Right Fit

Hiring the right assistant can be a challenge. In some ways, it's trickier than filling traditional management positions, because personal chemistry and the one-on-one dynamic are so important—sometimes more so than skills or experience.

Expert assistants understand the unspoken needs and characteristics of the people with whom they work. They have high levels of emotional intelligence: They respond to subtle cues and react with situational appropriateness. They pay close attention to shifts in an executive's behavior and temperament and understand that timing and judgment are the foundation of a smooth working relationship. A good assistant quickly learns what an executive needs, what his or her strengths and weaknesses are, what might trigger anger or stress, and how to best accommodate his or her personal style. Good matches are hard to come by: That's the reason so many good assistants follow an executive from job to job.

After many years of debriefing assistants who've been fired, I've identified several factors that make for bad relationships. The most common missteps an assistant makes are misreading the corporate culture, failing to build bridges with other assistants, failing to ask enough questions about tasks, agreeing to take on too much work, and speaking to external parties without authorization. Bosses usually contribute to these deteriorating relationships by not being open in their communications or not being clear about expectations.

There's an assistant I placed recently who's having trouble developing the right relationship with her boss. The executive called me and said, "Melba, I expected her to read through these memos and then get them out very quickly to my managers. But she left them on my desk, didn't call me over the weekend, and didn't send them out." I asked the assistant about it, and she said, "He didn't tell me it was important—I can't read someone's mind." But in fact, in this job you're supposed to be able to read minds—or, at the very least, you're supposed to ask questions.

SIMPLY PUT, the best executive assistants are indispensable. Microsoft will never develop software that can calm a hysterical sales manager, avert a crisis by redrafting a poorly worded e-mail, smooth a customer's ruffled feathers, and solve a looming HR issue—all within a single hour, and all without interrupting the manager to whom such problems might otherwise have proven a distraction. Executive assistants give companies and managers a human face. They're troubleshooters, translators, help desk attendants, diplomats, human databases, travel consultants, amateur psychologists, and ambassadors to the inside and outside world.

After years of cutting back, companies can boost productivity by arming more managers with this kind of help—and executives who are fortunate enough to have a skilled assistant can benefit by finding ways to delegate higher-level work to him or her. Executive-assistant relationships are business partnerships: Strong ones are win-wins between smart people. In fact, they're win-win-wins because ultimately the companies reap the benefits.

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FOR FURTHER READING
Robert C. Pozen lays out the principles of a more-productive work life in "Extreme Productivity," page 127.



Melba J. Duncan is the president of The Duncan Group, a retained search and consulting firm specializing in senior management support resources, and the founder of the Duncan Leadership Institute, which offers training for administrative support staff. She is the author of *The New Executive Assistant*.



The Cosmopolitan Corporation

Global success requires that companies appreciate diversity and distance rather than seek to eliminate them. *by Pankaj Ghemawat*



Pankaj Ghemawat is the Anselmo Rubiralta Professor of Global Strategy at IESE Business School in Barcelona, and the author of *World 3.0* (Harvard Business Review Press, 2011).

UNBALANCED GROWTH, pockmarked by financial distress. The threat of protectionism brought on by persistently high unemployment, particularly in developed countries. Tensions, in wealthy nations as well as poor ones, around ethnic, religious, and linguistic divides, and talk of a new age of secession or tribalism. These are some of the developments that contradict the story we had just gotten used to—the one about how markets were becoming perfectly integrated across borders, technology was obliterating distance, and national governments were now irrelevant. The aftermath of the financial crisis of 2008 reminds us of the many ways in which differences still matter.

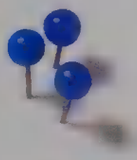
It also calls for a reassessment of what it means to be a global manager or corporation. Much of the management writing on globalism adopts the Enlightenment-era ideal, proposed by the 18th-century philosopher Immanuel Kant, of abandoning all "allegiances to nation, race, and ethnos" in favor of world citizenship. Take the strategy guru Kenichi Ohmae. In 2000 he published his famous book, *The Invisible Continent,* depicting a world in which businesses largely ignore geographic boundaries when serving markets and building supply chains. This kind of thinking isn't confined to management experts with an avant-garde view to promote: Forty-eight percent

of the respondents to an online survey that HBR conducted for me in 2007 agreed with the proposition "The truly global company has no home base." And among people with more than 10 years of international experience, 63% agreed.

Unfortunately, enticing though they may be, such beliefs don't bear up upon closer examination. Of course, they never did.

The Reality of Roots

The vast majority of firms are deeply rooted in their home countries. In 2004 less than 1% of all U.S. companies had foreign operations, and of those, the largest fraction operated in just one foreign country. The median operated in two foreign countries, and 95% in fewer than two dozen. Among the U.S. companies that were in one foreign country, that country was Canada 60% of the time and the United Kingdom 10% of the time.



90%

of the world's people will never leave the country where they were born.

2%

of all telephone calling minutes are international.

95%

of the news people get is from domestic sources.

Even the icons of globalization are less global than the rhetoric suggests. Remember ABB? Back in 1990, when *BusinessWeek* ran the cover story "The Stateless Corporation," that company, with its global nomad of a CEO, Percy Barnevik, was the lead example. The boundaries between ABB's Swedish predecessor ASEA and Swiss predecessor Brown, Boveri had ostensibly been broken down by putting the merged company's headquarters in Switzerland to balance the Swedish nationality of the controlling investors, the Wallenberg family, as well as of some key managers, particularly Barnevik. But the years after the merger were marked by what one insider characterized as internal warfare between the Swedes and the Swiss. Although things seem to have calmed down since then, it's more accurate to think of ABB as a company with a global presence but with particularly strong roots in Northern Europe and runners or prop roots in other geographies in which it has significant operations. Not as a company without any particular roots. That much is evident from looking at ABB's directors and top management (although a U.S. CEO was brought in from GE not long ago) and at its geographic distribution of assets and shareholdings.

Or, for an example in Asia, consider Rupert Murdoch and News Corporation's satellite TV network, Star TV. Murdoch and News Corporation had some elements of statelessness. They were major players from Australia to the United Kingdom to the United States, and Australian-born Murdoch had already become a U.S. citizen so that he could buy a set of American TV stations. But his experience across English-speaking countries didn't stop him from making some tremendous blunders in Asia.

Murdoch's original strategy for Star was to leverage News Corporation's English-language programming library across Asia, because many Asians of the target demographic spoke English. The company paid no attention to evidence from continental Europe that audiences strongly prefer local-language content, even if they understand foreign languages. Star TV's travails with language and culture paled in comparison with its political missteps. Shortly after acquiring Star, Murdoch pronounced satellite TV "an unambiguous threat to totalitarian regimes everywhere." The Chinese government reacted by banning satellite TV dishes. Much of Murdoch's China strategy has since involved digging out of this hole. The bottom line: Though News Corporation had transcended its Australian origins, it was still deeply rooted in a particular set of Anglo democracies that bore little resemblance to Star TV's target markets along some important dimensions.

If you're skeptical about the relevance of a corporation's nationality or the locations of its owners, ask yourself: Why are large export deals involving private firms often announced at meetings between the heads of national governments? Why do employees of foreign-owned companies often fear their career opportunities will be limited relative to their counterparts from the firm's home country? Which governments do firms call to represent them in World Trade Organization disputes (and to lead their bailouts in a crisis)? Why do foreign-ownership restrictions persist in industries like media (as well as various others, like airlines)?

It's not just firms and their business operations that remain deeply rooted. More important, it's the *people* who are their customers, employees, investors, and suppliers. Ninety percent of the world's people, it is estimated, will never leave the country where they were born. Two percent of all telephone calling minutes are international. People get 95% of their news from domestic sources, and those sources focus most of their coverage on domestic news. Only 21% of U.S. news coverage is international, and of that, half deals with U.S. foreign affairs. In European countries about 38% of news is international, but almost half relates to stories involving other countries in Europe. Only 5% to 10% of private charitable giving crosses national borders, and rich countries' governmental aid to the foreign poor, per person, has been calculated to be one thirty-thousandth the size

Idea in Brief

Much of the management writing on globalism adopts the Enlightenment-era ideal of world citizenship. Unfortunately, this is not realistic. The vast majority of firms are deeply rooted in their home countries. Even more important, so are the firms' customers, employees, investors, and suppliers.

Given this reality, global firms and managers must adopt a cosmopolitan approach of understanding and working with differences rather than against them. This has three implications:

Strategy
In the medium term companies should emphasize adaptation more than aggregation or arbitrage.

Organization
Companies must think about how to reduce or exploit external differences by managing internal, organizational distances.

People
Corporations will have to develop a cosmopolitan mind-set in people who have normal or typical attitudes and biases.

of aid to the domestic poor. As another 18th-century philosopher, David Hume, pointed out, "Sympathy... [is] much fainter than our concern for ourselves, and sympathy with persons remote from us much fainter than that with persons near and contiguous."

This is the reality of what I call World 3.0, a world that is neither a set of distinct nation-states (World 1.0) nor the stateless ideal (World 2.0) that seems implicit in the strategies of so many companies. Home matters in such a world, but so do countries abroad. And instead of everything being equally near or far, as German philosopher Martin Heidegger proposed in 1950, the law of distance continues to apply to many activities. As distances—geographic, cultural, administrative/political, and economic—increase, cross-border interactions tend to decrease. It's certainly possible to have a global strategy and a global organization in such a world. But they must be based not on the elimination of differences and distances among people, cultures, and places, but on an understanding of them. The mind-set, strategy, organization, and employees of these firms will not be oriented toward the global citizenship model implicit in corporate rhetoric. Instead, they'll start with a strong grasp of one's roots and what's distinctive about them, recognize relative similarities and differences, and flag the differences particularly worth watching out for. Because denying the existence of differences doesn't make them any easier to deal with.

Building a Cosmopolitan Understanding

Most executives' opportunity assessments rank markets by size, growth rate, and other indicators of long-term potential, such as demographics. In this approach, distance from a firm's home base or current markets is always a challenge to be overcome.

One way to break out of this trap is to use what I call a *rooted map* to ground your analysis. A rooted map resembles world maps that size countries according to measures such as population and GDP, but it focuses on measures that reflect a particular country's perspective. An Indian IT services company, for example, might use rooted maps like those in the exhibit "How Important Is Distance?" The first map takes a general Indian perspective by sizing countries according to their share of India's international trade. The second takes an industry view, with each country drawn according to the size of its IT services market. The third map combines the two perspectives, sizing countries on the basis of their purchases of Indian IT services.

> It's not just firms that are deeply rooted in their home countries; it's their employees and customers.

To gain insights, you need to make comparisons across maps and think about what kinds of distance influence the patterns they reveal. In this case, the first map shows how India's general trade pattern is sensitive to geographic distance, natural-resource availability, and historical connections. Nearby countries in Asia and along the resource-rich Persian Gulf are among its major trading partners, and we also see the legacy of India's historic ties to the former British Empire. The second map shows, unsurprisingly, that the largest IT services markets are the most advanced economies, whose per capita incomes make them distant economically from India.

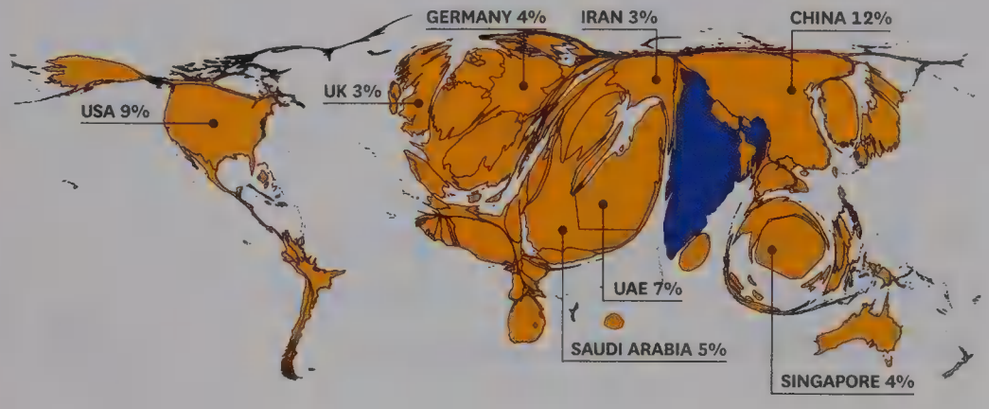
The first two maps suggest that without a more careful analysis, an Indian IT firm might follow India's general trade ties to the nearest major market—continental Europe. Indeed, one of the first large software projects offshored to India was for a Swiss clearinghouse. But the third map reveals that in IT services, linguistic distance matters more than geographic

How Important Is Distance?

The rooted maps below size countries according to their share of trade with India, their share of global IT spending, and their consumption of Indian IT services. They highlight how different kinds of distances matter for an Indian IT firm in search of growth.

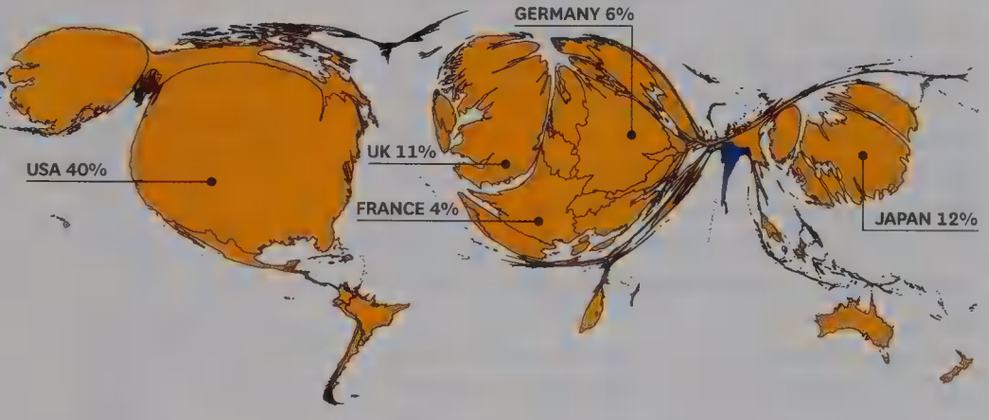
India's Bilateral Trade Pattern

India's general trade pattern is sensitive to geographic distance, natural resource availability, and ties to the former British empire.



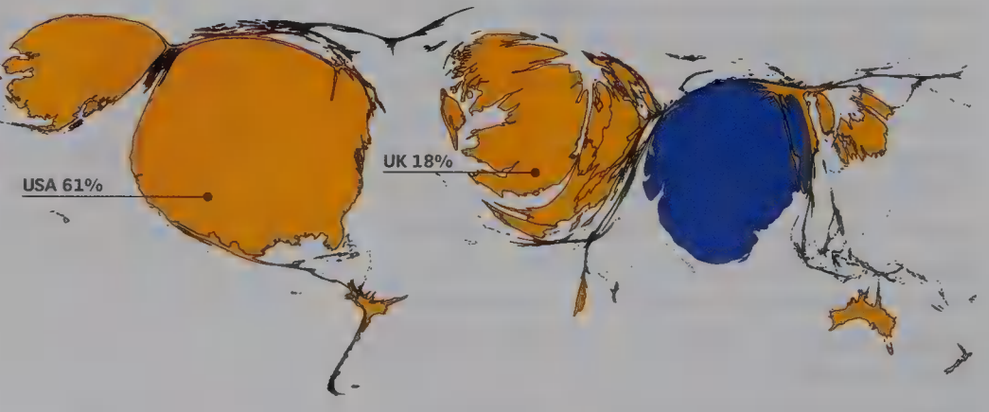
World IT Services Spending

Advanced countries are the largest IT services markets.



Exports and Domestic Consumption of Indian IT Services

For Indian IT firms, linguistic distance is an especially large consideration: English-speaking countries account for most of their business.



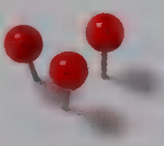
distance. Upwards of 85% of India's IT exports go to English-speaking countries. Though that makes continental Europe an obvious area for potential growth, operations there are usually less profitable than those in the major English-speaking geographies.

This example should make clear the importance of considering multiple types of distance and conducting analyses at the industry level. Your sensitivity to 1,000 miles of geographic distance is obviously much greater if you manufacture heavy goods than if you offer an online service. On the other hand it's less important to share a common language if you export cars than if you provide online training.

Rooted mapping is not just a global exercise. You need to analyze differences across regions and within countries as well. Indeed, the bulk of economic activity still takes place within national borders, and large gains can be achieved by carefully managing differences between provinces, ethnic groups, or language communities. For example, though nationalism and separatism are prominent in Spain's Basque Country, that region's trade with the rest of Spain is still 50% greater than its trade with the rest of the world. If tensions between the Basque Country and the central government in Madrid were reduced, Basque trade with the rest of Spain would presumably rise.

Companies and individuals vary in their ability to manage the same external distances. Businesses and executives from small home countries, for instance, are often more accustomed to dealing with cross-border differences than those from large home countries. Since Finnish norms aren't common in most of the markets Nokia sells to, its managers have had to learn how customers in other countries think. Americans, by contrast, are more likely to project their values or feel that other people need to do the changing.

Executives also need to think about how rooted maps are evolving. Which kinds of distances are expanding and which are contracting? What factors are driving those changes? In the current environment of protectionist rumblings and more-assertive governments, administrative and political distances seem to be increasing. And the shift in the locus of growth to large emerging markets—especially to the smaller interior cities within them—also adds distance along several dimensions for a typical U.S. or European multinational, which must learn how to bridge cultural and political differences and vast economic and geographic divides. On the other hand, trade agreements and new communications and transportation technologies can contract dis-



Companies are realizing that widely dispersed, low-cost supply chains make them vulnerable to protectionism, rising transportation costs, and quality issues.

tance (though the impact of new technologies is often overblown). In each case, the insights you glean from a careful analysis will inform your strategic and organizational choices.

Crafting the Cosmopolitan Strategy

In my 2007 book, *Redefining Global Strategy,* I described three fundamental ways that companies can create value across borders: the "AAA strategies" of *adaptation, aggregation,* and *arbitrage.* Adaptation strategies try to adjust to differences between countries and respond to local needs. Aggregation strategies attempt to overcome differences to achieve economies of scale and scope across national borders. Arbitrage strategies seek to exploit differences—by, say, buying low in one country and selling high in another. I advised managers to tailor a combination of these strategies to their company's industry, position, capabilities, and intent.

Though the AAA strategies remain the relevant consideration set for cosmopolitan corporations, in the medium term it may make sense for many companies to emphasize adaptation more than aggregation or arbitrage, given the public's current sentiment toward globalization. Such medium-term adjustments, however, must be checked against longer-term plans and expectations about how a firm's industry might evolve, because it can take years for companies to execute meaningful shifts among the AAA strategies.

The rationale for strengthening adaptation is threefold. First, if companies become more respectful of differences, people may be less inclined to demand protectionism. Second, when companies acquire foreign assets with little apparent rhyme or reason, as many did before the crash, they come across to the public as voracious and greedy. Showing regard for the sovereignty, uniqueness, and internal diversity of foreign markets can go a long way toward improving companies' reputations and, more broadly, the environment in which business as a whole has to operate. The rooted cosmopolitan corporation will be an active foreign investor across many locations but will pay careful attention to the cultural, political, and economic impact of its investment decisions. (For an influential conception of rooted cosmopolitanism at the individual level, see Kwame Anthony Appiah's book *The Ethics of Identity.*)

Finally, and perhaps most important, adaptation strategies are better suited to the opportunities opened by the shift in the locus of global growth. With growth slow in Western markets, Western companies must compete in big emerging markets like China and India. But they can't force their way in. They also cannot prosper by continuing the old practice of targeting elite customers in big cities, who tend to be more like customers back home. Western firms will need to take local competitors seriously and consider extending their presence to second- and third-tier cities, where more adaptation will be required.

But it is unfeasible to invest in every market in the world in an adaptive way. You need to zero in on the places where you're best positioned to add real value. That requires really understanding selected markets and demonstrating deep commitments there to customers, suppliers, governments, and the public at large—a far cry from the imperialist approach of pushing globally standardized products and pressing others to conform to your way of doing business.

Designing the Cosmopolitan Organization

When making choices about supply chains, organizational structure, foreign investment, and cross-border innovation, a cosmopolitan firm thinks about how to alter internal, organizational distances in response to changes in external differences. Take supply chain decisions. The trend toward significant offshoring will most likely continue. But many companies are becoming concerned that widely dispersed, low-cost supply chains make them vulnerable to protectionist governments, rising transportation costs, and quality



The most critical ingredient in a world that demands adaptation is a diverse management team.

problems. Some are taking steps to make their supply chains shorter, simpler, and stronger, in effect reducing internal distance within their production networks to better manage their exposure.

When it comes to innovation, many firms are similarly readjusting internal distances to reduce their sensitivity to external distances. In some cases this leads to an increase in internal distances. Innovation for emerging markets, for example, often requires different business models, not just whiz-bang technology. Corporate R&D labs located close to home in advanced markets may excel at creating technology, but firms seeking to develop products and business systems for markets abroad will increasingly need the informed creativity that only boots on the ground in those markets can provide. This suggests that Western multinationals may keep research mainly in the West but push development out to the large emerging markets. The street isn't one-way, of course; there's a lot of discussion now about transferring innovations from the emerging markets back to developed countries and adapting them for wealthier customers.

As the mix of a company's activities across countries changes, it's often wise to reexamine reporting relationships. Do they create unnecessary internal distance by routing too much through headquarters? Which decisions should be made at the country level? The regional level? The global level? More adaptation in a strategy might mean giving more authority to country managers. Should some functions be shifted from headquarters into regions where more of the related work actually gets done?

Perhaps the critical organizational ingredient in a world that demands adaptation is the composition of the management team. Most corporations are far from cosmopolitan. Even though GE deploys roughly half its assets in and generates half its revenues from markets outside the United States—and is justly famed for the breadth and depth of its top management—I reckon that about 80% of its top 200 managers are Americans. And among the vast majority of firms from emerging economies, management teams are much less international. This is true even for the very largest firms.

But simply adding foreigners to the management ranks won't make a firm cosmopolitan. First, their numbers must reach a critical threshold; a few token foreigners will probably have little impact. And second, when you put people of various nationalities together in a single corporation, you have to manage that diversity very carefully. Research suggests that unmanaged diversity is more likely to have negative than positive effects on group performance. People are more inclined to trust their fellow nationals, which often exacerbates tensions between headquarters and managers in far-flung foreign operations. And other research indicates that people's inclination to show sympathy is even more sensitive to cultural similarities.

People whose backgrounds are rooted in multiple cultures—so-called biculturals or triculturals—can play useful bridging roles in organizations. Studies also show that nationalism and suspicion of outsiders both decrease as a person's education level rises; one study found this to be true across the board in 10 countries with quite different educational systems. But large corporations can't rely on filling their management teams with individuals possessing bicultural or tricultural backgrounds and advanced scholarly degrees. They will have to develop rooted cosmopolitanism in people who have an average upbringing and education.

Cultivating the Cosmopolitan Leader

My own perspective is greatly influenced by my participation over the past two years in the Globalization of Management Education Task Force of the Association to Advance Collegiate Schools of Business. I wrote the portion of that group's report that focused on what business schools should teach their students about globalization and how—advice that could also help companies develop more-cosmopolitan managers. (See "Responses to Forces of Change: A Focus on Curricular Content," *The Report of the AACSB International Globalization of Management Education Task Force,* February 2011.) Four of the levers I identified seem particularly well suited to a corporate context.

Conceptual frameworks. It's overwhelming to try to develop an understanding of diverse places by studying them one by one—not to mention, to develop general knowledge of a variety of places all at once. But a survey of academic thought leaders points to the usefulness of conceptual frameworks

that emphasize the multiple dimensions of differences among countries. My own CAGE framework, which categorizes distance along the dimensions of culture, administration/politics, geography, and economics, is a fairly widely used one. Such frameworks bring order to masses of facts and fine-tune one's perceptions of foreign countries. Incorporating them into executive training can be very helpful. When businesspeople can make only short trips into a particular country, the ability to draw on frameworks can amplify what they learn on their visits—and help reduce the chances that they'll make costly missteps.

Longer and deeper immersion. Research shows that living abroad expands your mental horizons and increases your creativity. However, merely traveling abroad doesn't produce this benefit. Executives report that it takes at least three months to become immersed in a place and appreciate how the culture, politics, and history of a region affect business there. A number of leading MBA programs therefore incorporate long visits to sister or secondary campuses abroad rather than short visits that are often privately acknowledged to be little more than business tourism. So, though an anti-expatriation bias exists in many companies, it's important for executives to recognize that short-term stays have a limited impact. My advice to companies is to reconsider expatriation, especially for their high-potential managers. Of course, the high potentials may resist leaving their home countries for family reasons—or because it still seems to take longer to get promoted at many multinationals if your career path has taken you far from home base. Senior executives will need to create the right incentives for emerging leaders to invest in a cosmopolitan education.

Projects and networks. Participation in intercultural activities and networks (which corporations can easily facilitate through international projects) tends to soften ethnocentrism. Here, businesses have certain advantages over business schools. They can provide stronger incentives promoting particular behaviors that cultivate cosmopolitanism, have the opportunity to work with key executives over a longer time horizon, and can bind together diverse groups by promoting shared values, culture, and processes. They also have more scope to leverage online collaboration, translation, and social-networking tools, which very few companies (or business schools) fully exploit. But they must be mindful of cross-cultural differences in the use of such technologies; you can't just make a platform available and expect it to be readily embraced worldwide.

Assessment tools. Scholars have created a variety of assessment tools to reinforce programs aimed at improving international skills. In the AACSB report, I propose that every MBA graduate—and presumably, every global manager—have a minimum body of globalization-related knowledge, including:

- A handle on levels of and changes in cross-border integration of markets of various types.
- An understanding of how differences between countries can influence cross-border interactions—and how to look at them at the industry level.
- Awareness of the benefits of additional cross-border integration, and some perspective on the problems it's alleged to produce.

Other assessment tools focus on mind-sets rather than knowledge. One that will allow readers to compare their mental openness to the world with that of a highly international group of MBA students at a top school is the Global Attitude Protocol that I developed, which can be found at www.ghemawat.com.

In addition to pulling on these four levers, companies need to beware of behavioral and cognitive traps. For example, when managers do look at differences, they often focus on the most obvious ones while ignoring smaller ones. Yet smaller differences may be more important. For a Portuguese firm thinking of selling abroad, at least some of the differences and the challenges of the Chinese market will be obvious. But those of the Spanish market may attract less attention, even though Spain is the first foreign target for many Portuguese firms, and many stumble there.

WE SHOULD have been skeptical about the false ideal of statelessness from the start. "The Stateless Corporation" came out only three months after *BusinessWeek* had run another cover story, with the subtitle "Does the U.S. Need a High-Tech Industrial Policy to Battle Japan Inc.?" It's no different today. For every article or book you read about the world being flat, you'll read another that highlights the rise of state capitalism and the economic rivalries between China, India, and the United States. It's worth reemphasizing that the world is neither a collection of autonomous nations (World 1.0) nor perfectly flat (World 2.0), but semiglobalized, with some places being much closer to home than others. In such a world, rooted cosmopolitanism is a more realistic and, ultimately, more useful objective than statelessness.

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Fostering the Right Mind-set

Companies can help their employees develop cosmopolitan attitudes by pulling on four key levers:



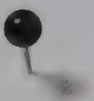
Conceptual frameworks
bring order to the mass of facts about foreign countries and help fine-tune executives' perceptions.



Longer and deeper immersion
is necessary to develop a true appreciation of how the culture, politics, and history of a region affect business there. That tends to require months, not weeks or days.



Projects and networks
that cross international borders soften the ethnocentrism of the executives that participate in them.



Assessment tools
can help companies get a read on managers' global skills and knowledge, and target areas for improvement.

How to Build Risk into Your Business Model

Smart companies design their innovations around managing risk. *by Karan Girotra and Serguei Netessine*



Karan Girotra is an assistant professor of technology and operations management at Insead.

Serguei Netessine is the Timken Chaired Professor of Global Technology and Innovation at Insead.



In early 2008 four entrepreneurs in Paris started MyFab, an internet-based furniture retailer that is doing more to change the industry than any other company since IKEA. Instead of building large stocks of furniture, as its competitors do, MyFab provides a catalog of potential designs. Customers vote on them, and the most popular ones are put into production and shipped to buyers directly from the manufacturing sites—with no retail outlets, inventories, complicated distribution, or logistics networks.

The engagement and social aspects of the voting attracted customers in droves, but they most loved the prices. By simplifying its supply chain and producing only what customers wanted, MyFab was able to offer products at significantly lower cost than established furniture retailers could. In just two years the company has grown to more than 100 employees; it now sells furniture and other products in four markets, including the United States.

MyFab did not identify new market segments, nor did it develop new products based on novel technology. In fact, its products are similar—often nearly identical—to those of its competitors. Like Dell, Zara, and Zipcar before it, MyFab has prospered by innovating its business model—the way it offers existing products or services that address existing customer needs using existing technologies. Very often this kind of innovation turns out to be more valuable and transformative than product- or technology-driven innovation, as readers of the work of Clay Christensen or Insead's W. Chan Kim and Renée Mauborgne well know.

But there's a perennial problem with business model innovation: Managers often find it harder to determine what changes to the model will work than whether a new product or technology will catch on. So what's the secret? How can companies system-

atically innovate their business models? How can executives identify and quantify the value of their changes? We believe that the literature on business model innovation has overlooked a critical driver of value: where in the value chain the risks associated with creating, supplying, and consuming products and services reside. In designing their value chains, companies typically focus on three things: revenue (price, market size, and ancillary sales), cost structure (direct and indirect costs, economies of scale and scope), and resource velocity (the rate at which value is created from the applied resources, typically captured through lead times, throughput, inventory turns, and asset utilization). These factors are well understood, and improving them is the main focus of management literature. Less well understood is that these value drivers are themselves affected by sharp changes in, for example, demand and supply. In thinking through changes to the business model, therefore, it is essential to examine the major sources of risk to the model and how the model will handle them.

Thinking in these terms quickly demonstrates the potential for companies to create value by redesigning their business models to reduce their risks. It can also reveal unsuspected opportunities for creating value by adding risk—if the company is well-placed to manage it. In the following pages we draw on our experience studying and consulting to dozens of companies—start-ups and large corporations alike—to describe the various types of risk-driven business model innovations and discuss their advantages and disadvantages.

Reducing Risks

Often companies that have lowered their business model risk have done so by delaying production commitments, transferring risk to other parties, or improving the quality of their information.

Delaying production commitments. Speeding up the production process is the most obvious way to do this. It usually means producing in higher-cost locations, which goes against supply chain orthodoxy. But surprisingly often the gains from reducing demand uncertainty outweigh the added costs. This approach lies behind some very remarkable innovations.

Consider the famous Spanish clothing retailer Zara. Branded clothing companies have traditionally focused on managing costs by organizing their sourcing, production, and distribution as efficiently as possible. As a result, they may need as long as 12 to 18 months to design, produce, and deliver a new line of clothing. That means they have to make big bets on future consumer preferences and demand. Bearing this risk has consequences for the bottom line through inventory write-downs (if the clothes don't sell) or for the top line through stock-outs (if people want more than you've made).

Zara reduced the likelihood of these consequences by designing a hyperfast supply chain that turns a new line around in two to four weeks—making it much easier to keep pace with consumer preferences. Of course, there is a price: The company makes most of its products in an expensive location (southern Europe), ships them to stores often (weekly), and uses an expensive mode of transpor-

Zara designed a hyperfast supply chain to make it easier to keep pace with customer demand.



Idea in Brief

Many managers find it harder to tell if changes in their business models will work out than to guess whether a new product or technology will catch on.

The secret to systematic business model innovation is to focus on identifying where the risks are in your value chain. Then determine whether you can reduce them, shift them to other people, or even assume them yourself.

If you take this approach, you won't need extensive experimentation and prototyping to identify very powerful innovations, because many tools for managing risk are available.

tation (air). But Zara's success demonstrates clearly that a focus on managing demand risks can trump a focus on costs.

Note that Zara did not discover anything new about the risks involved in retailing apparel. Everyone knows that customers are fickle and hard to read. Zara's insight was simply that a faster cycle time meant that decisions about product specifications and quantities needn't be made so far in advance, and fresher data would be available when the company did have to make commitments.

Reducing cycle time allows some companies to completely eliminate risks arising from demand uncertainty. Dell, for example, does not have to assemble a computer until the customer has ordered it, because it can turn the order around extremely fast. Again, a price must be paid: Like Zara, Dell must set up most of its production facilities close to its end customers (in the United States) and therefore cannot produce in low-cost locations for its main market. Similarly, Timbuk2, a popular bag manufacturer, can ship custom-designed orders to its customers in just two or three days—but its manufacturing has to be done in San Francisco rather than in China.

Rewriting your contracts. Another way to manage risk—especially asset-related risk—is to pass the exposure on to someone else. This usually involves altering your contracts with the other stakeholders in your value chain: employees, suppliers, and customers.

The customer-contact services provider LiveOps demonstrates how changing the terms of employment can radically alter a company's risk profile. Traditional providers of contact services maintain a workforce of customer service agents at a call center. The volume of service requests is highly variable, meaning that sometimes this workforce is underutilized for a large portion of the workday, but at other times the call volume far exceeds its capacity and customers must tolerate long waits. The usual solution is to relocate the contact center to a low-cost location such as India.

LiveOps turned this model on its head. Instead of employing and training a large workforce, it maintains a pool of loosely affiliated freelancers. These are often stay-at-home parents who cannot take a job with fixed hours but are available many times during the day. The LiveOps computerized system allows them to work remotely in their free time. Agents log on to the system when they're available, and customer calls are routed to them. Most important, LiveOps pays the agents only for the time that they are on support calls—meaning that the employees themselves bear the risk of their underutilization. They are willing to assume this risk in return for being able to make their own hours and work from home.

In the late 1990s Blockbuster handed off risk to suppliers: It revolutionized the highly competitive video rental industry by shifting away from fixed-price contracts (under which each VHS tape cost Blockbuster $60) and toward revenue sharing with the major movie studios. Under the old arrangement, the studios took little risk in terms of a mismatch between demand and supply: They received $60 for a tape no matter how many times it was rented. Blockbuster assumed all the risk of acquiring a dud and had to hedge its bets by buying fewer tapes.

Under the new arrangement, Blockbuster paid only $5 to $10 up front but shared about 50% of its revenues with the studios. This changed the studios' information sharing, pricing, and marketing incentives, with the result that Blockbuster could stock more tapes, increasing the availability of hit movies. The company's market share rose from 25% to 38%, and profits for the industry grew by up to 20%.

Gathering better data. Sometimes it isn't possible to radically shorten the production process or alter your relationship with other stakeholders in your value chain. In that case, you can improve the quality of the information on which you base your commitments.

That is precisely what MyFab's customer voting system does. The actual process of making and delivering



The Next Big Thing?

The idea of an environmentally friendly electric car has been around for almost 100 years. Multiple product and technology innovations have steadily advanced this industry but so far have failed to create wide-scale adoption.

WHAT ARE THE RISKS FOR SOMEONE WHO DECIDES TO USE AN ELECTRIC CAR?

The risk of running out of electricity in the middle of a trip. Current batteries last for only about 100 miles, and recharging them takes several hours.

The [illegible] risk associated with owning a battery. The battery is very expensive, and technology evolves quickly, so the owner has to maximize battery use despite being unable to drive long distances.

The data MyFab gets through customer polling reduce its exposure to stock-outs and excess inventory.

furniture quickly has been greatly refined, so relocating doesn't make as much competitive difference as it used to. The data MyFab gets through customer polling enable it to predict customer taste and demand levels more accurately than its competitors can, reducing its exposure to stock-outs and excess inventory.

Even when companies can reduce risk using the classic approaches, they should consider upgrading their information-gathering capabilities, because speeding up production or rewriting contracts often creates a new risk. This was a potential problem for LiveOps. Because its employees work from home and are independent contractors, it is much harder to verify that they are appropriately trained to answer calls. LiveOps mitigates this information risk by monitoring agents' performance and routing calls first to the higher-ranked agents.

Adding Risk

Many people regard risk only as something to eliminate—an undesirable concomitant of managing the resources and capabilities needed to deliver a product or service. But as the economist Robert Merton has often pointed out, one can also argue that companies create value by being better at managing risk than their competitors are. The implication is that if you are better than others at managing a particular risk, you should take on more of that risk.

The history of innovation demonstrates that quite a few companies have made money by taking on more risk—typically by changing the terms of their contracts with suppliers or customers. More than 30 years ago Rolls-Royce, a manufacturer of aircraft engines, identified a major pain point in the industry: Maintaining airplane engines is rife with risk for the airlines. Engine breakdown can ground a plane for weeks while the airline pays for repair time and materials. Airlines, especially small ones, don't always have the resources to adequately provide for such breakdowns.

So, in the 1970s, Rolls-Royce started offering the airlines a very different service contract: "Power by the hour." The airlines would pay Rolls-Royce for an engine's flight hours rather than for repair time and materials. Of course, much of the risk reduction the airlines obtained was reflected in the price, but transferring the risk had a more profound effect: Rolls-Royce was motivated to improve its products and maintenance processes, because the fewer the problems and the quicker the fixes, the more the manufacturer got paid. The airlines could never have created value in this way, either on their own or by prodding Rolls-Royce, so the new contract triggered a completely new value creation dynamic. This movement, which is often referred to as servicization, has spilled over to other industries. For example, the German rail vehicle manufacturer Bombardier charges its customers for maintenance according to miles driven, and Caterpillar charges construction companies according to the amount of earth moved.

Sometimes trying to avoid a risk actually increases it, and you can better manage it by being willing to own more of it. Take the car rental business. The risk in this industry lies in underutilizing fixed assets—cars. Traditional companies rent in daily increments, so the customer has to pay for a day even



HOW COULD THESE RISKS BE REDUCED FOR POTENTIAL ADOPTERS?

Think about Zipcar. Take on risk by offering customers the ability to exchange depleted batteries for fully charged ones. This requires building battery-switching stations.

Look at Rolls-Royce. Double the risk by transferring battery ownership from the customer to the company and selling the customer "driving distance" one mile at a time. A company that owns thousands of batteries not only can ensure that the batteries are properly utilized but also will be better positioned to forecast technology evolution and amortize expensive assets.

These solutions may sound familiar: The Israeli start-up Better Place has applied them both and is on track to enable electric-car adoption across Israel. Its business model innovation may achieve what technological and product innovation have long failed to deliver.

if he needs the car for only a few hours. He must assume the risk of underutilized assets.

In 2000 Zipcar turned this model upside down. It realized that the ability to rent by the hour would encourage people to switch from taxis or limos to Zipcars. It could price its offering to improve on alternative short-distance transportation modes and still earn a much higher hourly rate than conventional car renters. (Zipcars cost about $8 an hour, whereas the prorated cost at a traditional company is $1 to $2.) The company's annual revenues are approaching $200 million, demonstrating that returns on its new model outweigh the costs of maintaining a large fleet and multiple pick-up and drop-off locations.

Advantages and Challenges

The risk-driven innovation we describe has one important advantage over other forms of innovation: It's much cheaper. Innovating products and technologies often involves generating a lot of ideas and then trimming the list down through discussion, voting, and prototyping. Multiple iterations of prototypes, customer feedback, and experimentation are necessary. Significant R&D expenditures are often involved.

Risk-driven innovation, however, can be approached in a systematic way and with few expenditures, and relatively clear and credible estimates can be made of the potential benefits and costs. A great deal of research has been done on the pricing of risk, and sound methods exist for putting a dollar value on contracts and real options that involve reducing, transferring, or adding risk. In fact, a recent article by Suzanne de Treville and Lenos Trigeorgis ("It May Be Cheaper to Manufacture at Home," HBR October 2010) described how real options analysis lets you put a dollar value on the benefits of moving production from distant but cheap locations to close-by but expensive ones.

In addition, you don't need extensive experimentation and prototyping to identify very powerful innovations, because some of them have already been done and others can be quantified. Zipcar essentially reprised Rolls-Royce's approach, and Zara's innovation resembled Dell's. The sidebar "The Next Big Thing?" points out that a start-up in Israel is borrowing ideas from Zipcar and Rolls-Royce to introduce an electric car on a large scale (see "How to Jump-Start the Clean-Tech Economy," by Mark W. Johnson and Josh Suskewicz, HBR November 2009).

You might think that such innovations aren't a sustainable form of competitive advantage. But experience shows that they actually can be, because copying someone else's business model innovation often involves changing processes that are embedded in the culture of an organization—and substantially changing the cultural DNA is harder than adopting a new technology or design or entering a new market. It's particularly challenging when the company being copied is a competitor. Other car companies took decades to become as good as Ford is at mass production. And although the famous Toyota Production System is well described in numerous books, and anyone can visit a Toyota factory, U.S. automakers still struggle to implement it as effectively as Toyota does. Meanwhile, companies in other industries prospered mightily from being the first to adopt mass production or TPS.

The lesson: If you really want to steal a march on your rivals, shift some of the focus that you now put on improving your products and services to thinking about how you, your suppliers, and your customers can manage the risks of the business you conduct together.

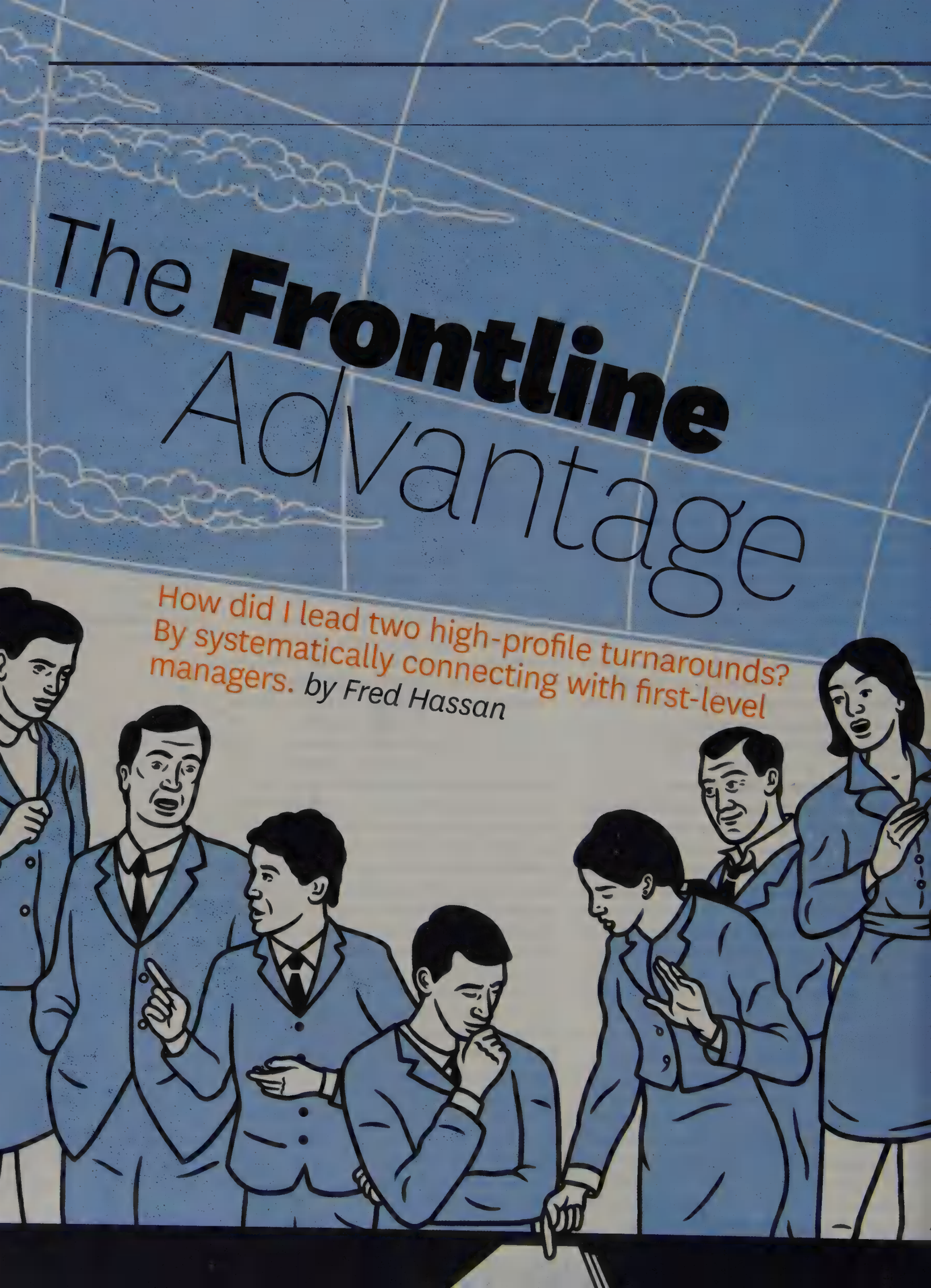
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FURTHER READING
More information on the concepts and case studies in this article can be found at **renaissanceinnovator.com**.

The **Frontline** Advantage

How did I lead two high-profile turnarounds? By systematically connecting with first-level managers. *by Fred Hassan*



Fred Hassan is a managing director at the private equity firm Warburg Pincus and the chairman of the board at Bausch + Lomb.



THE MANAGERS MOST responsible for a company's success or failure happen to be the ones with whom the CEO spends the least amount of time. The people I'm talking about are frontline managers—shop-floor supervisors, leaders of R&D or sales teams, managers in restaurant chains or call centers. They're at the very first level of management across a company's business operations and functions. Depending on its size, a company might have anywhere from 1,000 to 20,000 such managers. Typically, they make up 50% to 60% of a company's management ranks and directly supervise as much as 80% of the workforce.

It is the frontline managers who must motivate and bolster the morale of the people who do the work—those who design, make, and sell the products or deliver services to customers. These managers are central to a company's business strategy because they oversee its execution. They represent an all-important feedback loop that allows the CEO to stay abreast of the latest developments in the business. For all these reasons, frontline managers are a key CEO constituency, as important and deserving of attention and time as the senior executive team, business unit and functional heads, or major customers or investors.

Yet few CEOs think that it's their job to mobilize frontline managers. They may give the occasional speech during a site visit or hold a town-hall-style meeting or two. They may even practice some version of "management by wandering around" to stay in touch with different parts of the organization. But they rarely go far beyond such perfunctory measures. What they need to be doing is something

Frontline managers make up roughly

60%

of a company's management ranks.

altogether different: singling out frontline managers as a critically important group in the management ranks, spending significant personal time in direct interactions with them, and using those interactions to mobilize the entire organization. I call this approach *leading through the front.*

Leading through the front isn't easy. It demands a lot from the CEO: making strategic decisions about which frontline managers to focus on as leverage points in the organization, being savvy about when and how to interact with them, freeing up time and attention, and connecting the dots between what may seem like narrow problems facing frontline managers and larger issues facing the company. But it can be done. And when a leader taps into the enormous latent power tied up in a company's frontline managers, the payoff is a more resilient and more successful organization.

I'm a former CEO, so I'll talk about what I know: how CEOs can lead through the front. But the lessons are just as relevant to anyone who is heading up a large organization, be it a business unit, a corporate function, or a regional operation.

A Company of Passionate Drivers

I learned the importance of engaging with frontline managers over more than a decade as a turnaround CEO in the pharmaceutical industry. In 1997, I took the top job at Pharmacia-Upjohn, a company in so much trouble that one analyst wrote, "Only a miracle can save this company." I was able to bring it back from the brink, merge it with Monsanto into a new company called Pharmacia in 2000, and finally merge it with Pfizer in 2003 in a $62 billion deal that represented a 52% premium over Pharmacia's stock price.

Having worked myself out of a job, I next became CEO of Schering-Plough, a company facing multiple crises that threatened its very survival. In six years, I helped fix Schering-Plough's immediate problems, took sales from $9 billion to $20 billion, increased the number of late-stage drugs in the firm's portfolio from five to 12, and upped blockbusters from zero to five, making the company one of the top growth companies among its peers and a leader in relative total shareholder return. Schering-Plough's business became so attractive that Merck proposed a merger in 2008, which was completed the following year at a value of $46 billion—a 60% gain in Schering-Plough's stock price from when I had joined the company in 2003.

Both Pharmacia-Upjohn and Schering-Plough faced what looked like insurmountable problems. In both cases, I made engaging and motivating frontline managers a cornerstone of my turnaround strategy.

Many companies will never face situations as extreme as those at the companies I led. But nearly every business confronts unanticipated shifts in technologies and markets, major disruptions in traditional business models, pressures from customers, suppliers, and competitors (both incumbent and new), and consolidation among ever larger global players. It's no longer good enough for an organization and its people simply to keep executing past routines. Leaders must create an organization that is adaptable and highly responsive. Increasingly, companies need to build a culture of what I call *passionate drivers*—people who question the traditional way of doing things, dig into complex problems and stick with them until they are solved, and have an appetite to innovate.

In my experience, frontline managers are the key to bringing such an organization to life. After all, they are directly responsible for managing the vast majority of a company's employees and, therefore, have exceptional leverage on company performance. How they feel about senior management and the company as a whole influences the way they lead their people. When they are engaged and energized, they communicate that to employees. The result is a charged-up and aligned organization.

In addition, frontline managers are central players in a company's business strategy. Many executives assume that talking strategy with these man-

Idea in Brief

It's no secret that companies must be agile and responsive to succeed in rapidly changing markets.

What has been overlooked is the importance of frontline managers—shop-floor supervisors, leaders of R&D or sales teams, and the like—in creating such organizations.

CEOs and other executives should directly interact with small groups of frontline managers on a systematic basis. These conversations provide executives with timely, unfiltered information about what's going on in the business and help them spot opportunities and problems much more quickly.

Personal exchanges will also give executives an opportunity to explain the strategy to frontline managers and get them to own it. This is a big deal: When the people directly responsible for managing the vast majority of a company's employees are engaged and energized, the result is a charged-up and aligned organization.

agers will only distract them from focusing on their specific roles. I couldn't disagree more. In my experience, the hardest thing about strategy is the execution. How well frontline managers understand the company's strategy and their own specific role in it will in large part determine whether that strategy is successful. It's the CEO's job to communicate the strategy to them directly and get them to own it.

Finally, frontline managers are a powerful untapped resource for the CEO. Despite all the innovations in communications technology, one of the biggest challenges facing the leader of any large corporation is getting timely, unfiltered information about what's going on in the business. Frontline managers have their fingers on the pulse of operations and of the marketplace. Easy and open communication with them helps the CEO detect unanticipated developments and respond to them rapidly.

Getting Started: The CEO Dialogue

The first step for a CEO who wants to lead through the front is to make time for regular interactions with selected frontline managers. This sends the message that he or she believes their work is important. But the real value comes from exposing the CEO to issues that these managers are dealing with.

Routine interactions needn't be a burdensome commitment: They can be folded into things the CEO is already doing. For example, just about every CEO I know spends a considerable chunk of time visiting company operations around the world. Typically, site visits involve discussions with local management, meetings with customers and government officials, and sometimes a larger event with the local workforce. Frontline managers should be a priority on these visits.

Soon after I first became a CEO, I decided that I would meet with representatives from the frontline community, both formally and informally, on every site visit I made, to communicate my vision and solicit their perspectives and concerns. I continued to hold formal business reviews with the local general manager and his or her team. But I also met with frontline managers without any local top management present. We called these meetings CEO Dialogues, and over the years, my staff and I developed some simple rules for making sure that they were effective. (See the sidebar "Cultivating Effective Dialogue.")

Taking the "Trivial" Seriously

When engaging with frontline managers, you have to be willing and able to get into the nuts and bolts of the business. If you're in a meeting with frontline managers and don't know what makes their part of the business tick, they'll sense it immediately. They may even call you on it.

Sometimes you'll find yourself getting involved in issues that, at first glance, may appear to be unworthy of CEO attention. Don't let that stop you. You'll

Frontline managers directly supervise around

80%

of the total workforce.

Cultivating Effective Dialogue

by Ken Banta

It's not easy orchestrating a frank and constructive dialogue between a CEO and frontline managers. Some individuals may feel intimidated when they find themselves face-to-face with the CEO. Others may be so determined to stand out that they dominate the conversation. Still others may seize the opportunity to air a litany of long-held grievances. Or the CEO may appear distant or distracted or, alternatively, too fixated on delivering a specific message.

Drawing on our experience of organizing hundreds of such meetings, first at Pharmacia-Upjohn and Pharmacia, then at Schering-Plough, and now at Bausch + Lomb, my colleagues and I have developed a three-step model for cultivating an effective dialogue.

Select the Participants

A CEO dialogue should include no fewer than eight and no more than 10 frontline managers. Too few participants tends to inhibit the conversation with the CEO; too many can turn what should be a genuine dialogue into a minilecture. We work with HR and department heads to identify managers who are high performers and recognized thought leaders in their units. Participants receive a personal invitation from the CEO. A facilitator (usually a member of the CEO's immediate staff) attends each meeting to manage the flow of the conversation and document the discussion.

learn that what seem like trivial issues or problems often turn out to be incredibly important.

At one Schering-Plough CEO dialogue, for example, frontline sales managers in our Russian operation told me that their single biggest complaint was how long it took to get corporate approval to assign a company car to a new sales rep. Believe me, I had more-important issues on my plate—or so it seemed. But in troubleshooting the problem with my staff, I realized that this issue was much bigger than just the cars themselves.

Obviously, having to take a bus or a subway or a train to visit customers was an obstacle to sales force productivity. Worse, though, we were losing some really good reps to competitors for no other reason than that they were promised immediate use of a company car.

I came to see that the business environment in Russia was developing so fast that it resembled a kind of gold rush. We needed to free up the local organization from some of the usual corporate bureaucracy, bring in better and more entrepreneurial people, and compete harder and more flexibly for the best talent.

The experience ended up affecting my whole approach to that part of the world. I significantly accelerated Schering-Plough's activities in the region. As a result, we were able to gain a position in the Russian market that was stronger than those of much larger competitors—all because I heard district sales managers complain about how difficult it was to get a company car.

Deciding When to Go Deep

All frontline managers are important, but at different times some are more important than others. For instance, certain groups may be especially critical to resolving an immediate crisis facing the organization. Others may be central to realizing the company's long-term strategy. As circumstances demand, groups may require more than just the occasional routine interaction, and the CEO will need to get deeply involved in their work.

When I joined Schering-Plough, its top line was dropping, and the company was burning cash. A major source of the problem was the ineffectiveness of our U.S. sales organization, which was responsible for generating roughly half our total revenues. The group wasn't meeting its targets, and there was a lot of frustration and finger-pointing. To make matters worse, some of our sales and marketing practices were being investigated by U.S. attorneys for possible violations of the law.

As I saw it, the organization needed a whole new approach to selling. Instead of focusing, as usual, on high-pressure tactics to maximize short-term results, our sales reps needed to become more professional, more focused on building deep, long-lasting

Organize the Meeting

Make sure that the meeting room is intimate. Ideally, the table should be round or oval, and participants should be seated close to one another. The meeting should be held on the frontline managers' turf to make the point that the CEO is coming to them. Find out which participants are likely to be less vocal and place them directly opposite the CEO to encourage their engagement.

The dialogue should feel structured but informal. The CEO starts by laying out the goals of the meeting: (1) for managers to hear updates about the company's progress and priorities and (2) for the CEO to listen and learn. Next, the group proposes topics for discussion. The facilitator clusters them into topic areas and kicks off dialogue.

The CEO should strive to make the participants feel like trusted confidants and ambassadors. The facilitator ensures that everyone has a chance to speak, keeps the conversation focused, and takes detailed notes.

Share Output and Follow Up

A detailed summary of the meeting and agreed-upon action items should go to each member of the executive team, keeping participants' comments anonymous. Local management can be briefed when appropriate. The facilitator is responsible for making sure that action items are taken.

The final step is to communicate. Telegraph the importance of frontline managers by showcasing highlights from the meeting in CEO communications and on the intranet. Announce action items that are under way to illustrate that the CEO is listening to, learning from, and acting on frontline insights.

The CEO seals the new bonds by sending a personal thank-you e-mail or—even better—a handwritten note.



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customer relationships. I wanted our customers to view them as trusted consultants rather than as traditional salespeople. This would amount to an enormous cultural change. Sales reps would need to develop in-depth knowledge not only about the full range of products in our portfolio but also about the science behind the products. We would have to address highly sensitive issues such as how reps were paid (relying less on monthly commissions and more on fixed salary) and challenge assumptions about what constituted high performance and how it would be rewarded. We would need a wholesale change in the mind-set of our sales reps and their attitudes about their role.

I knew I was putting the roughly 400 district sales managers in a very tough spot. As the direct managers of Schering-Plough's 4,000 U.S. sales reps, they would be the tip of the spear of my plan to reinvent the company's sales culture. To be successful, they would have to learn new leadership skills. As the brand-new CEO who was proposing this major change effort, I had to take the lead as their mentor, teacher, and coach. During my first two years at Schering-Plough, I worked closely with the sales managers to communicate my vision, get their buy-in, and model the new behaviors that they would need to model for the sales reps.

I decided that the first large company event I attended as CEO would be the annual meeting of the entire U.S. sales force. A few weeks before the event, I met with the district sales managers to tell them what I intended to say: We were going to change the way we did things and start emphasizing new values such as "business integrity" and "putting customers first." I told them that they had an absolutely central role in the effort. Their support at the annual meeting was crucial to bringing the reps along.

For a long time after the event, I made it a practice to hold one-on-ones with many of the sales managers to discuss the specific challenges each was facing with his or her reps and to ask how I might help. I even had my training staff create a handbook that spelled out their new leadership role. That handbook became the prototype for a companywide frontline-management training program designed to help all new managers plan their first few months on the job.

It was a long, hard slog to change our sales culture. Some reps who had been among the highest earners under the old commission system decided to leave. But after about a year, I knew that our efforts were paying off. One indication was that some of the company's oldest products, which had been posting declining sales, began to take on new life. That meant our reps were selling a fuller portfolio, not just pushing the latest products. Another was that in customer satisfaction surveys, scores for some of our key sales groups, such as specialty sales and managed care, went from the bottom quartile to the top. Eventually,

as the new sales culture took hold and the U.S. district sales managers became confident in their own leadership skills, I was able to pull back from my heavy involvement.

Exposing Senior Managers to Frontline Perspectives

One of the key tasks for any CEO is to be the architect of how decisions get made in the company. A CEO who leads through the front will incorporate voices from the frontline ranks into management's decision-making process. The point is not necessarily to give frontline managers new decision rights. Rather, it's to make sure that their point of view is heard by the senior managers making the decisions.

A good example of how I did that at Schering-Plough concerns another major crisis the company faced. Not long before I became CEO, the U.S. Food and Drug Administration had hit the company with a $500 million fine (the largest in the FDA's history) for what regulators considered inadequate quality management in the company's manufacturing systems and insufficient commitment on the part of management to solving the problem. Upon being appointed CEO, I had signed an ongoing consent decree, which among other obligations made me personally responsible for more than 200 improvements in our manufacturing operations. If the company failed to show regular progress, we were liable for quarterly fines and worse. An elaborate and costly structure of project teams had been put in place to make the improvements.

To monitor progress, I scheduled a recurring meeting called the CEO Biweekly. There were about 15 regular attendees, including the company's top manufacturing executives, the plant managers from our four U.S. manufacturing sites, and middle managers overseeing the effort. In addition, I often brought in supervisors from the four plants—frontline managers who ran the production lines and were members of the improvement teams—to report on specific initiatives.

I had included the plant supervisors because I wanted to keep the process honest. At one point, for example, it became clear that our improvement efforts were falling behind schedule. Everybody had a theory about why this was happening, but I wanted to know what the supervisors thought. They told us that the reason was simple: Despite our complex infrastructure of improvement teams and all the money we were spending on designing solutions to the problems, at the end of the day it was the plants' production schedulers who controlled what happened on the lines—and their decisions were driven exclusively by the demands of the production schedule. As they understood it, their job was to make sure production targets were met. The result was that they weren't allowing enough downtime for the engineers in charge of making the necessary improvements to work on the lines. So the CEO Biweekly group came up with a new policy that was widely communicated and reinforced: Engineering improvements were as high a priority as production—and the schedulers had to work with the improvement teams to manage the trade-off between those two goals, not just optimize one. Who knows how long it would have taken to arrive at that simple solution if we hadn't listened to the managers on the ground?

The Power of a Higher Purpose

Immediate crises like those I faced at Schering-Plough can devour a CEO's attention and time. Be careful that they don't cause you to neglect other key groups of frontline managers. Often there are units that don't represent a big part of the current business or are not facing an immediate problem but whose activities are absolutely critical to a company's future. Here, too, the CEO who leads through the front has a crucial role to play as champion and chief motivator.

In the pharmaceutical industry, for example, a company's future is only as good as its R&D. Lead times are long, and failure rates are high. It's a tough job that's getting even tougher as regulatory agencies introduce stricter standards for drug approval, governments put pressure on companies to lower prices, and biomedical science becomes more complex. In my experience, the key differentiator between success and failure in pharmaceutical R&D is not so much the knowledge or expertise of a company's researchers (although, of course, that is important) as it is the level of their personal engagement and motivation—especially in the face of unforeseen obstacles and setbacks. That's why I've made it a priority in every company I've led to connect with the frontline managers leading our R&D teams, understand the challenges they face, and go out of my way to show that I personally value their efforts.

One time, at Pharmacia-Upjohn, while visiting our R&D facility in Uppsala, Sweden, I was shown a new delivery mechanism for our human growth

hormone Genotropin. Because the recipients of human growth hormone are children, device technology is important: The less intrusive and painful the mechanism for delivering the drug, the better. The prototype was a penlike device with a spring-loaded needle that allowed for a quick injection. But there was some concern because using the device required injecting the drug into the belly, which children might find scary.

The moment I was handed the saline-filled prototype, I proceeded to inject myself. In part, I was gathering data. I realized, for instance, that the injection could be administered so easily and so quickly that it would be over before most children had even focused on it. But I was also sending a message. The people standing around me were startled to see the CEO engage in such a visceral way. They understood that I really felt the issue was important.

Another effective way I have found to unleash personal engagement and emotional energy is to infuse people's tasks and goals with a sense of higher purpose—above and beyond the economic or strategic goals of the company. A higher purpose isn't just window dressing, peddled to prospective employees or the public. It's a very pragmatic way of strengthening organizational resilience.

In 2007, Schering-Plough acquired Organon BioSciences, which previously had been a division of the Dutch conglomerate Akzo Nobel. Researchers at Organon had developed a medication called asenapine that showed promise for treating bipolar disease and schizophrenia. The company had licensed the product to Pfizer, but the compound had been languishing in late-stage trials for years. In October 2006, Pfizer had walked away from the drug. Both investors and investment bankers took Pfizer's action to mean the drug had no future; they placed little or no value on it during our M&A due diligence.

But in getting to know the researchers who had developed asenapine, I was impressed by their commitment to creating drugs to combat serious mental disease, a major area of unmet medical need. Their determination made me think the drug just might have a future—but only if they put their all into getting the compound approved. I didn't talk to them about the potential impact of asenapine on Schering-Plough's top line or our need to restock the company's product portfolio. I told them that patients suffering from mental disease were counting on them. Eventually, they were able to resolve the obstacles keeping asenapine from final approval, and today it is one of the few new medications that have been approved in the United States for use with patients suffering from bipolar disease or schizophrenia. We succeeded in part because by appealing to the R&D team's sense of higher purpose, we unleashed the energy and motivation necessary to find a solution.

Empowering the Front—Without Undermining the Middle

One response I get frequently from executives when I talk about leading through the front is "Doesn't that risk undermining your middle managers?" It's a legitimate question—and it applies to senior managers as well. You have to strike a delicate balance between empowering frontline managers and making sure

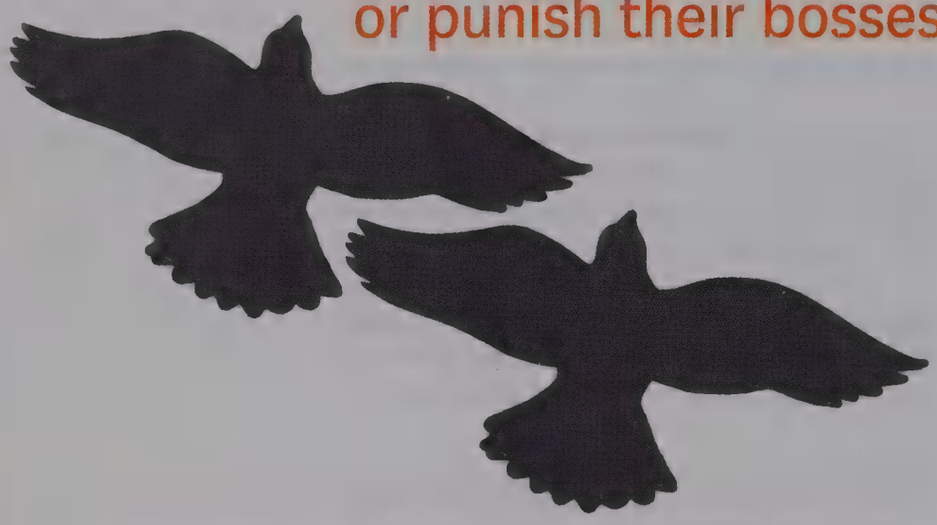
You have to empower frontline managers, but make sure you don't short-circuit the formal chain of command.





CONNECT WITH THE AUTHORS Do you have questions or comments about this article? The author will respond to reader feedback at **hbr.org**.

Never use the information you learn from frontline managers to discipline or punish their bosses.



your actions and responses don't short-circuit the formal chain of command.

It's important to communicate to managers at all levels that frontline managers are a critical part of the enterprise and that it is the job of everyone, not just the CEO, to support them and learn from them. And when it comes to sharing information, leading through the front is an open system. It is not permissible for anyone to use the chain of command to hold on to—let alone hide—information that ought to be shared. At the same time, however, you should never use the information you get from frontline managers to discipline or punish their bosses. The response should always be at the level of company policy, not individual performance.

Here's an example of what I mean. In the course of working through the problems facing our manufacturing operation at Schering-Plough, I got to know a number of manufacturing supervisors who were informal leaders in their plants. I treated these shop-floor influencers as my eyes and ears in our manufacturing operations. I went out of my way to develop personal relationships with them. I told my administrative assistant to put through their calls no matter what I happened to be doing. I even gave some of them my personal cell-phone number.

One evening, I got a call at home from one of these supervisors. Our senior manufacturing executives had recently made a decision to shift production of one of the drugs made in his plant to a facility in Canada. The change wasn't scheduled to take place for some time. The supervisor had called to tell me that, in an effort to save money, the plant manager had decided not to purchase an important piece of equipment necessary to keep up with state-of-the-art quality-assurance standards. The supervisor was worried that the decision would compromise our new emphasis on high quality. Frankly, I agreed with him.

But here's the critical part of the story: My first reaction wasn't to call up the plant manager and chew him out. After all, we were also emphasizing the efficient use of capital throughout the company. I could see how, from his perspective, the decision to move the production line might look like a good opportunity to save on his capital expenditures. Still, if the savings were going to compromise quality, even temporarily, then the decision was a bad one.

Instead of going directly to the plant manager, I worked with my senior management team to establish a new company policy: As long as a manufacturing plant was responsible for producing a specific drug, it was required to invest in the production line—right up to the moment the drug was transferred to a different site. The company's long-term manufacturing strategy shouldn't undermine its commitment to best-in-class quality assurance and compliance.

In the end, far from opposing the empowerment of frontline management, the other management ranks at Schering-Plough came to welcome it. Why? Because the more that frontline managers themselves could function as engaged leaders, the better their bosses and bosses' bosses could do their own jobs.

I remember the moment when I first realized that the notion of leading through the front had taken hold. It was soon after we rolled out our company-wide frontline-management training program. I was worried that it would be difficult to persuade senior managers to make time to host the kickoff meetings for the three-day training sessions. To my surprise, there were so many volunteers that we had to turn people away. They realized that empowering the front line had the secondary effect of empowering them as well. What leader could ask for more?

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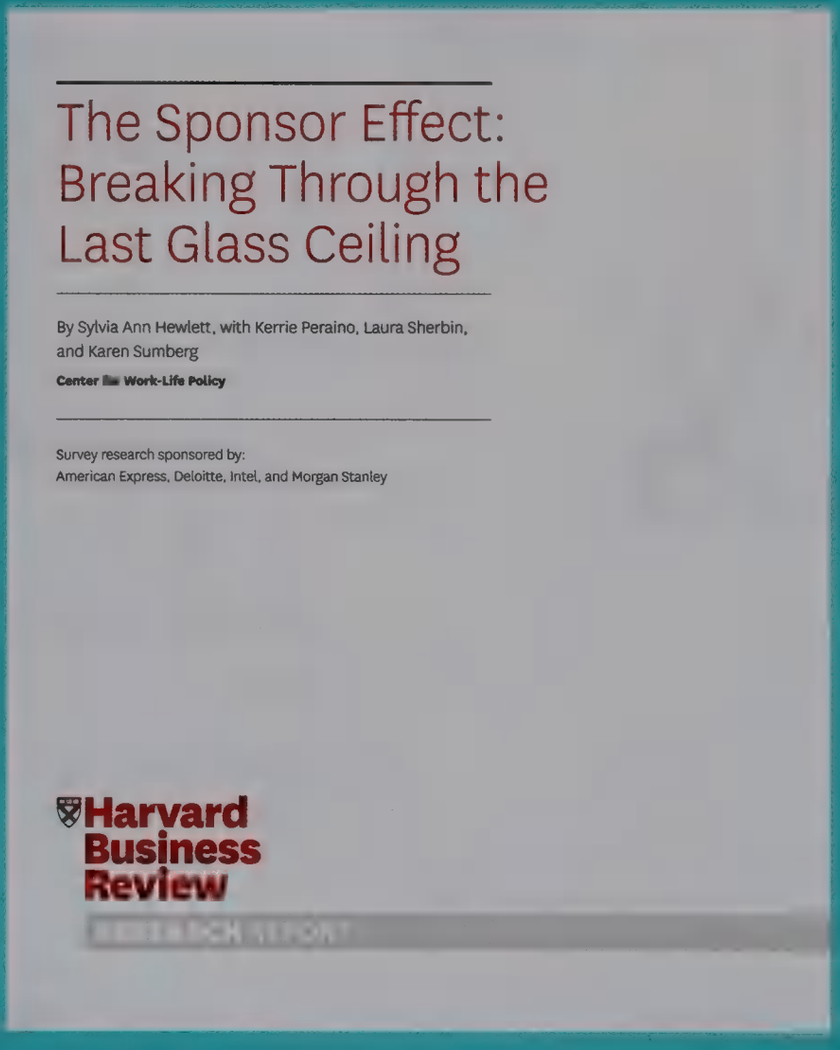
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Cracking the Next Growth Market: Africa

The continent is home to many of the world's biggest opportunities. The trick is deciding where and how to seize them. *by Mutsa Chironga, Acha Leke, Susan Lund, and Arend van Wamelen*

A year ago, when South Africa hosted the World Cup of football, a Tswanian phrase, *Ke Nako* ("It's Time"), reverberated across the world like the cacophony of a million vuvuzelas, announcing that Africa's moment had come. Economists, consultants, and executives all suggested that the African economy, which had languished during the last two decades of the 20th century, was finally stirring.

Nevertheless, most companies have been slow to enter Africa. Many assumed that the flutter of attention was the reflection of a global boom in commodity prices, and therefore of relevance primarily to oil and mining companies. The recent political turmoil in such countries as Algeria, Egypt, Libya, Morocco, and Tunisia and the civil war in Ivory Coast have dramatically reminded executives of the enormous uncertainty that businesses must cope with in Africa. With prodemocracy movements breaking out in some of Africa's fastest-growing economies, multinational companies face a double bind: Some of the most promising countries present the highest risks.

That's not all. In Africa the infrastructure is still poor; talent is scarce; and poverty, famine, and disease afflict many nations. Most Western executives, unsure of the size of Africa's consumer markets, prefer to invest in Asia's dragon and tiger economies rather than in Africa's economic lions. "Is it truly Africa's time?" they wonder.

So often were we asked the question that last year McKinsey & Company decided to analyze Africa's economies and conduct a microlevel study of its consumer markets. Our goal was to identify Africa's sources of growth, determine if it would continue over

In 2008, Africans spent $860 billion on goods and services—35% more than Indians spent.

time, and size opportunities in key sectors. (For the full analysis, see *Lions on the Move: The Progress and Potential of African Economies* at www.mckinsey.com/mgi.)

The findings surprised us. Over the past decade, Africa's real GDP grew by 4.7% a year, on average—twice the pace of its growth in the 1980s and 1990s. The surge cut across nations and sectors. By 2009, Africa's collective GDP of $1.6 trillion was roughly equal to Brazil's or Russia's. The continent is among the fastest-expanding economic regions today. In fact, Africa and Asia (excluding Japan) were the only continents that grew during the recent global recession. Though Africa's growth rate slowed to 2% in 2009, it bounced back to nearly 5% in 2010, and in 2011 it is likely to touch 5.2%.

While political troubles, wars, natural disasters, and poor policies could slow Africa down, the prospects for consumer-facing companies are bright. Africans spent $860 billion on goods and services in 2008—35% more than the $635 billion that Indians spent, and slightly more than the $821 billion of consumer expenditures in Russia. If Africa maintains its current growth trajectory, consumers will buy $1.4 trillion worth of goods and services in 2020, which will be a little less than India's projected $1.7 trillion but more than Russia's $960 billion.

As Africa's economies progress, opportunities are opening in sectors such as retailing, telecommunications, banking, infrastructure-related industries, resource-related businesses, and all along the agricultural value chain. Consider that telecom companies in Africa have added 316 million subscribers—more than the entire U.S. population—since 2000. According to UN data, Africa offers a higher return on investment than any other emerging market. For several reasons: Competition is less intense and few foreign companies have a presence there, and pent-up consumer demand is strong. Companies that desire revenues and profits, we believe, can no longer ignore Africa.

Smart multinational companies are busy planting their stakes in the ground. Nokia and Coca-Cola have distribution networks in nearly every African country; Unilever has a presence in 20 African nations, Nestlé in 19, Standard Chartered Bank in 14, Barclays in 12, and Société Générale in 15. Homegrown giants are expanding: Ecobank and South African Breweries each operate in over 30 African countries, while MTN and Shoprite are in 16 African countries each. Companies that enter Africa now, we believe, can shape industry structures, segment markets, and establish brands.

The Growth Ahead

Busy executives may wonder whether the African economy's recent growth is just a flash in the pan. After all, the economy had picked up during the 1970s oil boom, but when oil prices fell, it began to slow. In our opinion, Africa's long-term prospects are strong, because both internal and external trends are propelling its growth.

To be sure, Africa is benefitting from the increases in commodity prices. Oil prices have shot up since 1999, when they were less than $20 a barrel, reaching more than $145 a barrel in 2008, and prices for minerals, grains, and other raw materials have also soared. Yet that trend explains only part of the African story. Natural resources directly accounted for just about a quarter (24%) of GDP growth from 2000 through 2008, according to our calculations. Other industries, such as wholesale and retail trade, transportation, telecommunications, and manufacturing, contributed the rest. In fact, countries that export commodities grew just a tad faster, at 5.4% a year, than nonexporters, which on average grew 4.6% from 2000 through 2008.

Three factors are responsible. One, several African countries, such as Angola and Mozambique, halted deadly hostilities, creating the political stability necessary for growth. The number of serious conflicts in Africa—those in which deaths exceed 1,000 people a year—declined from an average of 4.8 a year in the 1990s to 2.6 in the 2000s. Two, economies became healthier as governments shrank budget deficits, trimmed foreign debt, and brought down inflation. Since 2000, African countries have cut their combined foreign debt from 82% of GDP to 59% and reduced budget deficits from 4.6% of GDP to 1.8%, which sent inflation rates tumbling from 22% to 8%.

Three, several governments adopted market-friendly policies. They privatized state-owned enterprises, reduced trade barriers, cut corporate taxes, and strengthened regulatory and legal systems. Nigeria, for example, privatized more than 116 enterprises between 1999 and 2006; Morocco and Egypt struck free-trade agreements with their main export partners; and Rwanda established courts to settle business disputes. These and other steps helped local companies invest more, achieve greater economies of scale, and become more competitive.

Africa will continue to profit from the rising global demand for oil, natural gas, minerals, food, and other natural resources. The continent has an abundance of riches, including 10% of the world's oil reserves, 40% of its gold ore, and 80% to 90% of its deposits of chromium and platinum group metals. To exploit them, African govern-

ments are forging new types of partnerships in which buyers from countries such as China and India provide up-front payments, invest in infrastructure, and share management skills and technology.

Long-term growth will get a boost from Africa's demographic and social trends. The population is young, growing, and migrating to the metropolitan centers. In 1980, 28% of Africans lived in cities; today 40% do—a proportion close to China's and larger than India's. Workers in cities earn higher pay than those in rural areas and can afford to buy products and services beyond the necessities of food and shelter. That expands demand, which leads to a virtuous cycle of growth and job creation.

Many people picture Africans as subsistence farmers, but there's a sizable middle class on the continent. By 2008, 16 million African households had incomes above $20,000 a year—a level that enabled them to buy houses, cars, appliances, and branded products. Another 27 million households earned $10,000 to $20,000. In addition, 41 million households reported incomes of $5,000 to $10,000—the level at which families start spending more than half their income on nonfood items. By 2020 the total number of households in all three segments will reach 128 million, which should make Africa one of the fastest-growing consumer markets of this decade.

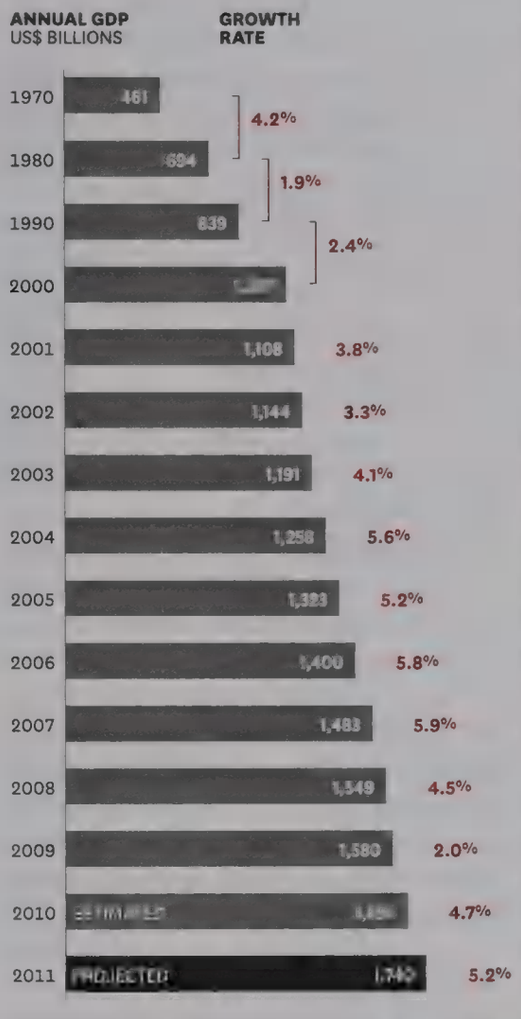
Categorizing the Opportunities

Corporations must start developing their strategies by recognizing that Africa isn't one economy. It's home to 50-plus nations, each with its own policies and attitudes toward multinational companies, as well as its own languages, currency, and traditions. Successful companies use filters to decide which countries to enter and tailor their entry strategies to specific sectors. They focus their efforts on key markets, but those that think broadly benefit from greater scale and diversified risks.

Economists usually group countries by income level or geography, but we organized them according to their economic

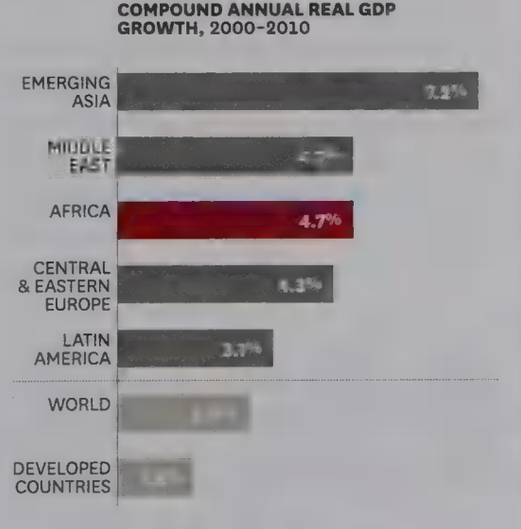
Readying for Takeoff

Africa's growth accelerated rapidly after 2000 and continued even during the global recession.



NOTE GROWTH RATES FOR THE 1970S, 1980S, AND 1990S ARE COMPOUND ANNUAL RATES.

Since 2000, the continent has been the world's third-fastest growing region, outpacing Eastern Europe and Latin America.



SOURCES INTERNATIONAL MONETARY FUND, GLOBAL INSIGHT, MCKINSEY GLOBAL INSTITUTE

diversification and level of exports. As economies develop, agriculture and natural resources account for a smaller and smaller share of GDP, while the share of manufacturing and services grows. That boosts per capita income, with a 15% increase in manufacturing and services as a share of GDP usually resulting in a doubling of per capita income. Exports are the means by which emerging economies earn hard currency to pay for imports of capital goods. In most African countries, capital goods imports account for roughly half of investment, making exports a critical enabler of growth.

Classified by these two parameters, which together provide a snapshot of how developed markets are, African countries fall into four broad clusters. (See the exhibit "Four Types of Economies.") This framework can guide executives as they assess which markets to enter and how.

The diversified economies. Africa's four most advanced economies—Egypt, Morocco, South Africa, and Tunisia—have well-developed manufacturing and service industries. They have relatively high per capita incomes and more stable GDP growth than most of the other economies, despite the political risks that have come to the fore in North Africa. Services, such as banking, telecom, and retailing, have accounted for more than 70% of GDP growth in these countries over the past decade.

These countries are also Africa's largest consumer markets; 90% of households there have some discretionary income. That makes them ideal places for consumer-facing businesses to anchor their operations. Walmart, for example, recently struck a $2.4 billion deal to pick up a 51% stake in one of South Africa's largest retailers, Massmart, which has stores in 13 other African countries.

However, these economies have higher labor costs than China or India and struggle to compete even in low-value manufacturing industries. They need to expand exports, improve education to create a skilled workforce, and build infrastructure.

The oil exporters. Africa's oil and gas exporters have the continent's highest per

capita incomes but are the least diversified economies. Three of the largest—Algeria, Angola, and Nigeria—have already attracted the world's petroleum majors and have rapidly growing consumer markets. In Angola, for instance, retail banking is expected to grow by 6.8% a year through 2020, telecommunication services by 5.2% a year, and nonfood consumer goods by 4.4% a year. Because of their income levels, the oil exporters are attractive markets for high-end goods and services.

Africa's oil exporters face the same challenges as many resource-rich nations: maintaining political stability; resisting the temptation to overinvest, which would make them vulnerable if commodity prices decline; and creating a diversified economy. Nigeria has already begun the transition to a diversified economy. While resources have accounted for 35% of the country's GDP growth since 2000, services have accounted for 37%. The number of telecommunications subscribers there increased from practically zero in 2000 to 63 million by 2008, and banking assets grew fivefold.

The transition economies. Africa's transition economies—such as Ghana, Kenya, Uganda, and Senegal—have lower per capita incomes than the countries in the first two groups but are growing rapidly. Though their agriculture and resource sectors together account for as much as 35% of GDP and two-thirds of exports, these countries increasingly export manufactured goods to other African countries. The penetration of banking, telecom, and modern retailing is much lower than it is in the diversified economies, but that offers attractive opportunities.

Companies targeting these markets must tailor products to poorer customers. Still, early entrants will find less competition here, and the rapid growth is expected to continue. Several transition economies are likely to increase their commodity exports in the coming years, which could turbocharge growth. In Ghana and Uganda, for instance, recent oil discoveries will boost tax revenues, making it easier for them to diversify their economies.

The pretransition economies. These economies are poor, with annual per capita GDP of just $353 on average. But some of them are expanding rapidly. The three largest—the Democratic Republic of the Congo, Ethiopia, and Mali—have grown, on average, 7% a year since 2000. However, their growth has been erratic in the past.

These pretransition economies differ greatly, but all of them lack the basics, such as stable governments, strong public institutions, and sustainable agricultural development. Multinational companies must track these economies, but only those that can handle the risks should enter them.

Four Keys to Success

Winning in Africa requires executives to understand the business environment in each country they enter and to tailor their plans accordingly. It demands innovation; the winners are often companies that tackle complex challenges creatively. In our work, we have found four other elements critical to success in Africa.

1. Pick the right entry strategy. Once a company has identified the countries and industries in which it would like to have a presence, it must choose an approach. Should it start from scratch and grow on its own? Should it build a presence by acquiring small local players? Should it take a stake in a Pan-African player?

The answer will depend on the industry. In relatively well developed sectors such as retail banking and telecom, it's probably too late to deploy only an organic strategy using traditional business models. African banks, such as Ecobank and Standard Bank, as well as foreign banks like Standard Chartered and Barclays, have already spent decades establishing operations in many countries. More recently, some have grown their footprints by buying up local banks.

New entrants will increasingly have to use M&A as an entry strategy. One option is to knit together a Pan-African operation by acquiring regional players. Another is to buy a stake in a big African company. That's what China's ICBC did, purchasing 20% of Standard Bank in 2008. The alliance gave ICBC immediate access to the 17 African countries in which Standard Bank operates and enabled it to finance the activities of Chinese companies all over Africa.

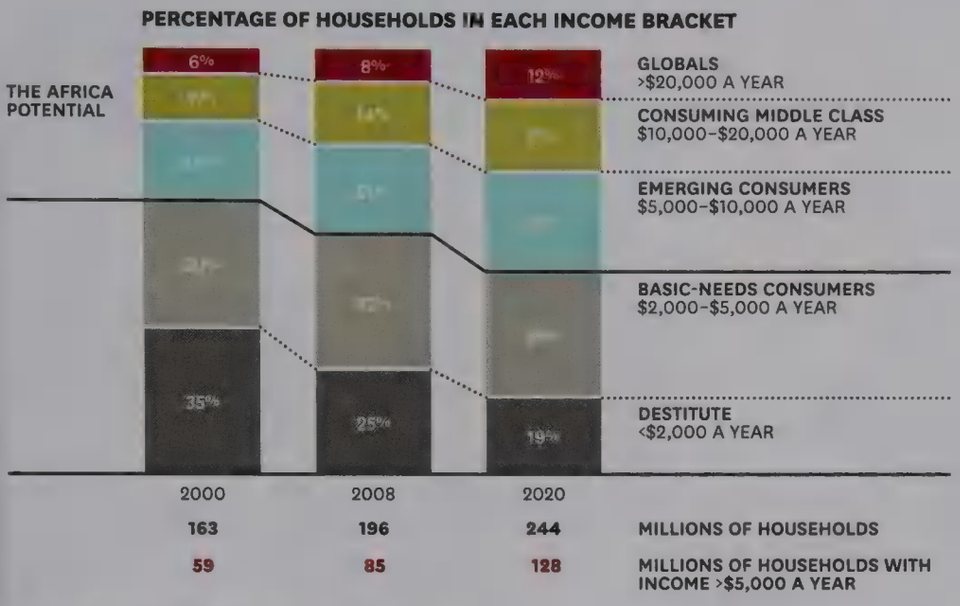
Organic growth strategies are possible in sectors such as retailing. Formal retailing is limited in most African countries, and that allows global players to move in. Zara, the Spanish retailer, has opened 12 stores across North Africa in the past five years. Shoprite had just one store outside its home country of South Africa in 1995 but has since become the continent's largest food retailer, opening 71 stores in other African nations. Organic growth is also possible in industries where disruptive technologies create new products and services. Consider Safaricom's mobile-phone-based money-transfer service, M-Pesa, which enables customers to deposit and withdraw money from a network of agents. Launched in Kenya in 2007, M-Pesa captured 6.5 million customers in just two years' time, and it has since been launched in Tanzania and South Africa as well.

2. Get—and get to—customers. Consumer preferences vary enormously across Africa, so companies must invest in market intelligence. Brand-conscious consumers will save up to buy premium items, but

The economies of the Democratic Republic of the Congo, Ethiopia, and Mali have grown 7% a year since 2000.

Surging Consumer Demand

By 2020, more than half of Africa's 244 million households will have annual incomes of more than $5,000, suggesting that they will enjoy discretionary spending power.



NOTE ANNUAL INCOME FIGURES IN US$ PPP 2005.
SOURCE CANBACK GLOBAL INCOME DISTRIBUTION DATABASE; MCKINSEY GLOBAL INSTITUTE

most people have low incomes and lack access to credit. Using imaginative strategies—selling products in small quantities; offering credit, hire purchase, and layaway plans; and educating consumers—is essential. Developing innovative, low-priced consumer products and services is often critical. For example, Nokia focuses on phone models priced from $20 to $50 and adjusts profit targets to reflect the lower prices instead of adopting a global benchmark.

Reaching customers is arguably as tough as understanding their needs. Africa's infrastructure is poor, and more sales occur through informal channels, such as vendors and family-run businesses, than through stores and malls. Companies can overcome these challenges only by being flexible. Some foreign companies have a single national distributor; others over half a dozen. But all find they need more people to manage distributors in Africa than they do elsewhere. In Nigeria, P&G appointed exclusive distributors for seven geographic areas and hired employees to support each one, which it doesn't do in any other country. You must be patient—building a logistics network in Africa takes time. P&G spent 10 years building its Nigerian network.

Multinationals can hasten the expansion of formal retailing channels by co-investing in mall development or selling through multibrand stores. One successful European retailer has become a mall developer in Africa, which ensures strategic locations for its stores as well as anchor tenants for its malls. Shoprite is taking a similar tack as it expands across the continent.

In many African countries informal retail channels account for more than 80% of retail sales. Companies must find innovative ways to work with them. Coke has created a network of micro distribution centers to reach informal retailers in both rural and urban areas. It comprises 2,800 small businesses that use bicycles and manual pushcarts to deliver products over unpaved roads.

Infrastructure gaps demand creative solutions from service providers, too. For example, to ensure that it has continuous electrical power, Africa's largest cellular services operator, MTN, has built generators into each of its 5,000-plus towers in Nigeria. It uses a fleet of trucks to feed them diesel. By providing better service, MTN has acquired 31 million subscribers and built a $4.5 billion business in the country. Despite the added costs, its profit margins in Nigeria are routinely above 50%.

3. Fill the skills gap. High-skilled workers in Africa are similar to those in other emerging economies. The best-educated attend top universities, often overseas. Each year 200,000 students from sub-Saharan Africa study abroad. At the other end of the spectrum, there's also little difference between Africans and workers from other developing economies. One study found that factory workers in Kenya are as productive as those in China and India, but the overall production costs in Kenya are higher because of poor regulation and infrastructure—problems that are likely to go away.

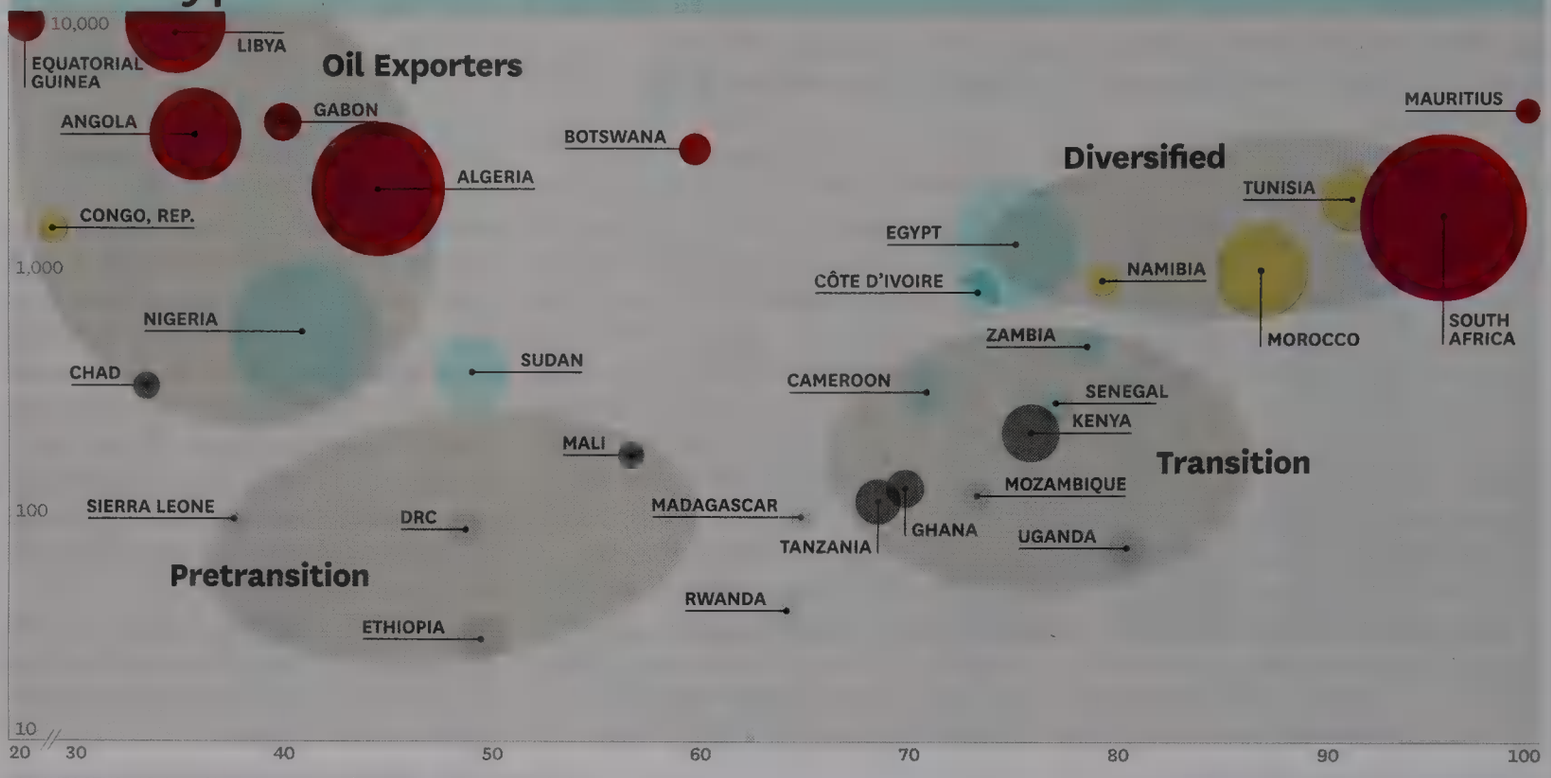
What's missing is a cadre of midlevel managers—a shortage that reflects the weaknesses in Africa's secondary and tertiary education systems. To fill the gaps as their operations grow, multinational companies use several strategies:

Bringing in midlevel expatriates. Particularly in the early years, foreign companies import managers to start operations and groom local talent. Successful organizations create clear expectations about talent development; draw up targets; and monitor progress. One multinational company has reinforced its middle management in Nigeria with expatriate managers from other emerging markets, such as India, who have the skills and experience needed to deal with the Nigerian environment.

Setting up extensive training programs. Multinationals usually find that employees at all levels in Africa need training. Some invest in the local education system to develop people with the skills they require. Such programs may also help them win support from governments; companies can leverage them to obtain permits to enter markets, get tax credits, or gain access to land and other resources. A major oil company in Angola has created a program to train 14- to 16-year-olds as upstream specialists. It also works with a local university to increase the number of engineers and scientists graduating every year and funds a law program in oil and gas that produced its first class, of 28 graduates, in 2008.

Insisting on global rotations. Other corporations rotate senior executives and emerging leaders recruited in Africa

Four Types of Economies



Africa's 50-plus nations are at different stages of development, as their widely varying levels of exports and economic diversification reveal. They fall into four main categories: oil exporters, diversified economies, transition economies, and pretransition economies.

SOURCES ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT; WORLD BANK WORLD DEVELOPMENT INDICATORS; MCKINSEY GLOBAL INSTITUTE

through positions abroad so that they can bring home an array of skills to share. A case in point is the financial services firm Old Mutual, which maintains a constant flow of talent between its offices in Africa and those overseas.

Buying talent. Entry strategies that rely on M&A have one key advantage: the talent that comes with acquisitions. Mobile Telecommunications Company, for example, inherited a slew of senior and midlevel executives when it bought Celtel, then Africa's leading mobile player, six years ago.

4. Manage risks. Political instability is one of the two biggest risks foreign companies face on the continent, as the world is witnessing in North Africa. The other is adverse actions by governments, such as reneging on contracts or passing legislation that hampers operations—which some resource companies have experienced in West Africa. Abrupt changes in import tariffs and quotas can also affect operations.

Diversifying across geographic markets mitigates these risks. In addition, companies can create coalitions of stakeholders that help them detect potential problems early so that they can head them off or draw up contingency plans. Companies can do this in three ways:

Building partnerships. Local businesspeople and politicians usually know the political landscape and learn of changes long before they hit the news. Such partners can help foreign companies navigate bureaucracies and foster relationships with official and unofficial powers.

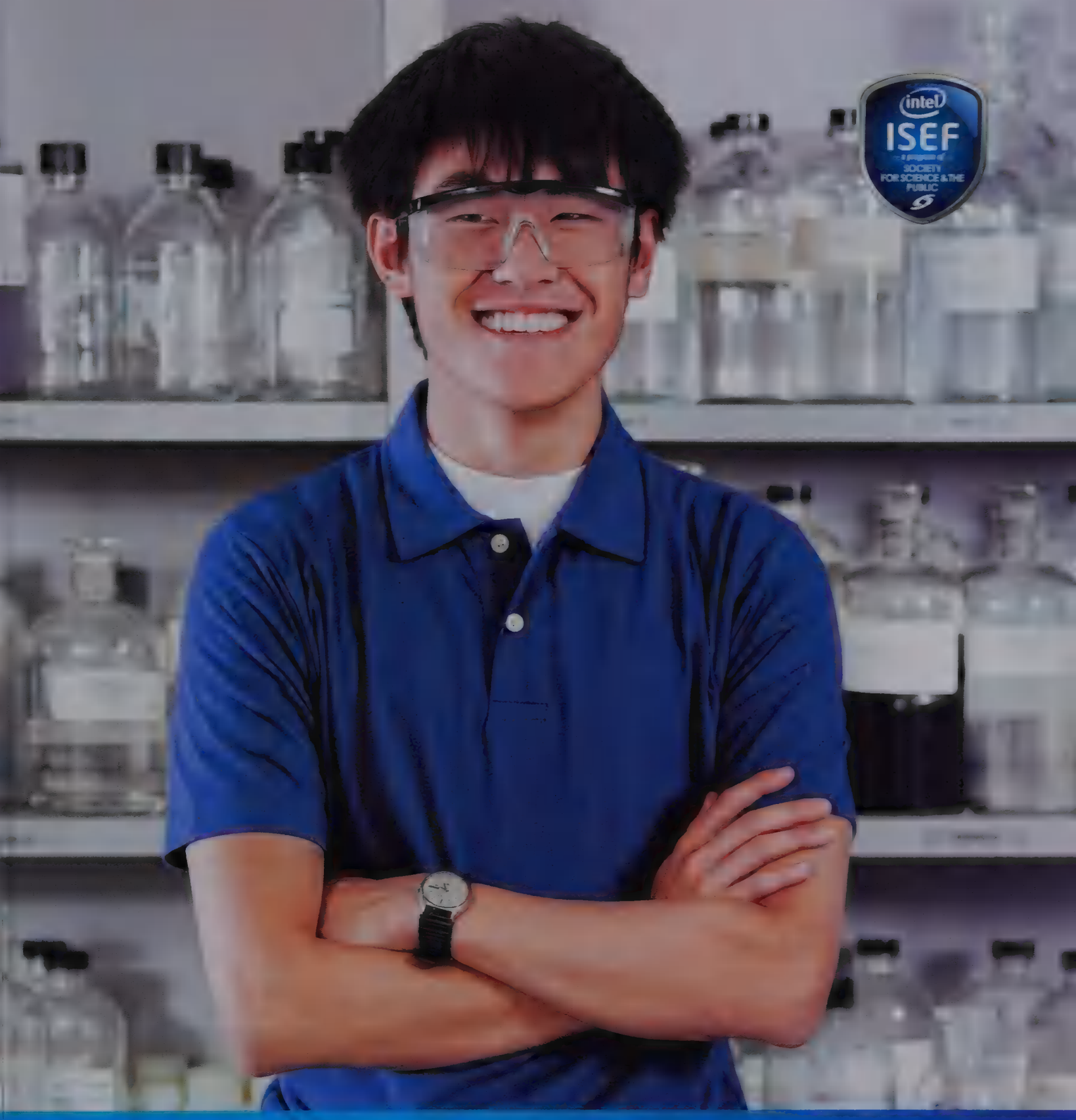
Wooing the influentials. Smart companies identify key influencers, such as congressional representatives, regulators, and mayors, in each country. They take the time to figure out, say, who among the top 50 influencers are their strong supporters; who's indifferent but can be turned into a supporter; and who'll never support them. They actively cultivate the first two groups.

Putting key stakeholders on their boards. Inviting key public and private sector stakeholders to join a country board aligns their incentives with the company's. It gives the locals a stake in the company's success.

IN MANY ways Africa holds the same potential that China did 20 years ago. A large rural population is moving to the cities, landing jobs with higher incomes, and starting to enjoy discretionary spending. Demand is growing, and foreign direct investment has soared: from $9.4 billion in 2000 to $46.4 billion in 2009. Just as investing in China embodies some political risk, so too does doing business in Africa. Companies must think carefully about the approaches they adopt, but it will be worthwhile. Above all, first movers will have the opportunity to forge strong local partnerships and capture market share before everyone wakes up to the buzz around the Bright Continent.

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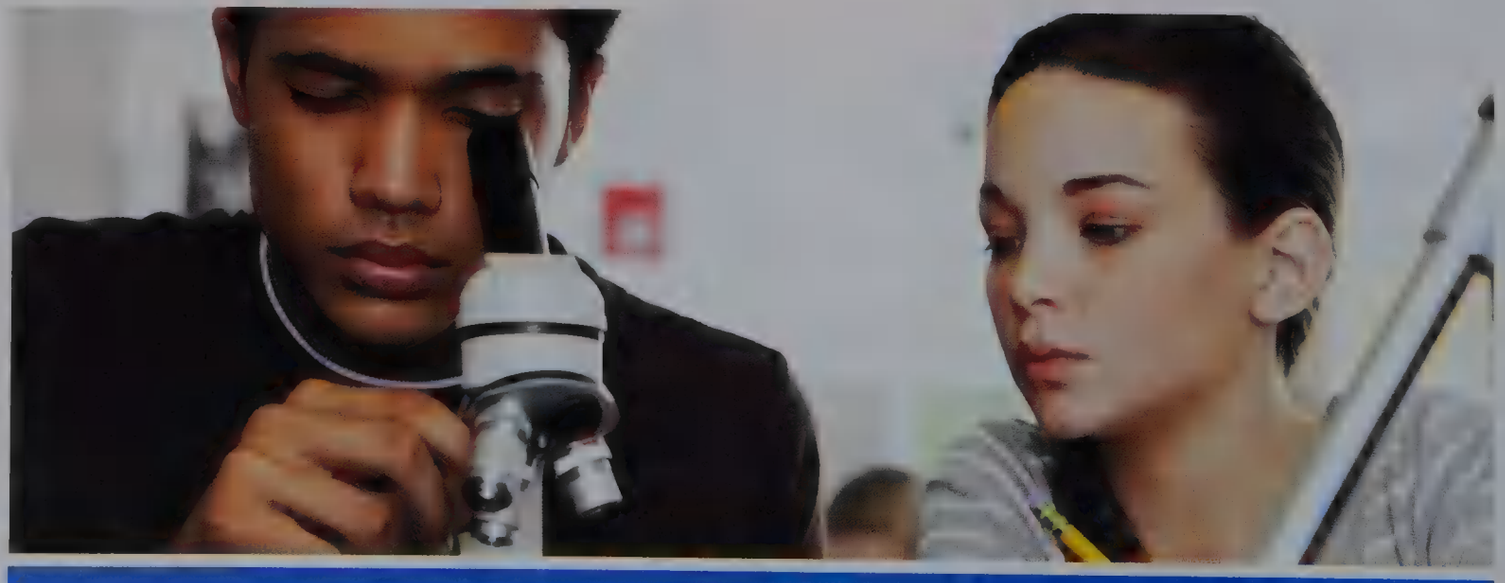
—Paul Otellini, President and CEO, Intel Corporation

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ERIKA ALDEN DEBENEDICTIS
Traveling the Interplanetary Superhighway

As a young girl, Erika became fascinated by pictures of interplanetary travel on the pages of her father's science magazines. Years later, she remembered those pictures and became interested in researching how spaceships might be able to travel through the universe, without the need for refueling.

She developed a software navigation system that would allow spacecraft to exploit low-energy orbits for travel on what NASA scientists call Interplanetary Superhighway. Her work is based on the concept that the gravity and movement of planets create a network of low-energy opportunities that allow for more efficient transit routes through the solar system.

Working at home and building on existing research, Erika developed an original optimizing search algorithm that discovers energy-minimizing routes in specified regions of space and would allow a spacecraft to adjust its flight path en route.

Erika, who won the 2010 Intel Science Talent Search, believes this single-step method of repeated orbit refinement could work with essentially autonomous spacecraft and may be a practical step forward in space exploration. The technology also might someday provide a way to tow asteroids toward earth for mining. "By using the gravity of other planets and low-energy trajectories, we could make money!" she says.

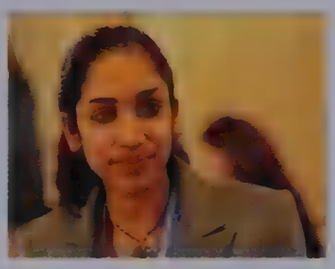


ALYDAAR RANGWALA
Finding the Cure for Autoimmune Diseases

While working on a volunteer project in high school, Alydaar met several children with Langerhans cell histiocytosis (LCH), an autoimmune disease in which the body attacks its own normal cells. After one of the children died, Alydaar immersed himself in researching ways to treat LCH.

The research led him to hypothesize that long wave UV light (UVA1) might be a viable treatment for LCH, and he began a two-year study using special UVA1-generating LEDs. Unlike other light waves, UVA1 is extremely safe due to its low energy. His research project, conducted on mouse tissues, found that dendritic cells, critical to forming and controlling immune responses, migrate toward UVA1 light. When UVA1 light was directed at mouse skin, the dendritic cells migrated to the skin's surface. This could be beneficial in fighting autoimmune diseases such as LCH and lupus, because by pulling dendritic cells out of the bloodstream and into the skin, an overactive autoimmune response can be controlled.

Alydaar believes this UVA1 effect might help the body combat several diseases and someday provide an alternative to chemotherapies. "This could be safer than chemotherapy, because it targets specific cells and doesn't aggressively shut down the whole system. And it could be cheaper, because it's a therapy from a light source that can be plugged in and used again and again," he says. "It's exciting to work on something with such potential for real-world application."



NAMRATA ANAND
Searching for Extraterrestrial Life

The astronomical exploration of the universe fascinated Namrata, particularly the tracking of what scientists dub "galaxy cannibalism"—the way that smaller satellites are drawn in and then "eaten up" by bigger galaxies. So working with her mentor, she began research that used spectral analysis and nearly a decade's worth of data to find key information about the chemical enrichment history of the Andromeda Galaxy—leading her to new thinking about how that galaxy and others are formed.

By qualitatively and quantitatively analyzing the chemical spectra of two populations—red giants in the Andromeda Galaxy field and nearby dwarf spheroidal satellite galaxies—she demonstrated that the Andromeda field sample is chemically richer.

She believes that her research may someday have the potential to help space explorers identify locations in space with a high probability of extraterrestrial life. "Our goal as a species is to constantly push the limits of our thinking—thus it's very important that we appreciate research projects that further our understanding of our place in the universe," she says. "Although my research was somewhat of a history project, such spectral analysis projects can help us identify stars with high metallicities, stars around which chemically enriched, Earth-like planets may orbit."

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CRUCIBLE 132
What a Chinese travel entrepreneur learned from her SARS shutdown

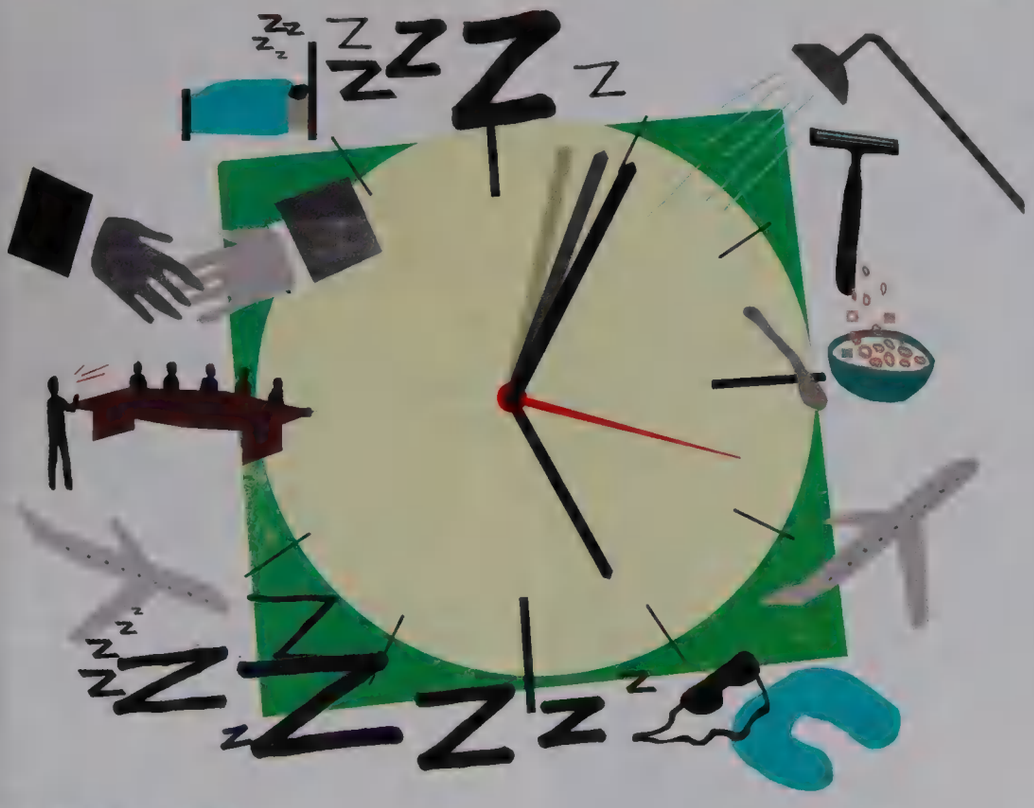
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MANAGING YOURSELF

Extreme Productivity

A veteran executive outlines the principles for getting a lot done. *by Robert C. Pozen*

Bob Pozen does a lot. He's been a top executive at two mutual fund giants, Fidelity and MFS Investment Management. He's also been an attorney, a government official, a law school professor, a business school professor, and a prolific author. And he has often been several of those things at once. Yet Pozen never comes across as overwhelmed, frazzled, or even all that busy. We know this because he's a frequent contributor to HBR and hbr.org—with a reputation around our offices for writing faster than we can edit. Our experiences with him led us to wonder if he might have something interesting to say about personal productivity. So we asked him about it. The result was a series of blog posts for hbr.org (http://s.hbr.org/eDJ4g4), which Pozen has here distilled into six principles for a more productive work life.

PRINCIPLE 1

Know Your Comparative Advantage

Many CEOs I've encountered say, "Here are the top five priorities for the company. Who would be the best at carrying out each one?" Then they propose themselves for all five areas. That might be the right answer, but it's the wrong question, because it's based on a self-centered concept of comparative advantage. It focuses on what an executive does best rather than on what the organization most needs from him or her.

The correct question is, "Which functions can only you as the CEO perform?" You may be the only executive who can meet with a top regulator or persuade a key client to stay. You may also be essential to recruiting senior staff. But a CEO has to hold back from taking on other responsibilities even if he or she excels at delivering on them. When CEO Rob Manning recruited me to join MFS as chairman, in 2004, we explicitly divided the high-priority functions. Although I had run the investment management group at Fidelity, Rob is a talented investment guy and a natural leader who wanted to take charge of that group at MFS. We agreed that I wouldn't even show up on the investment floor.

The same applies to midlevel executives. You may be outstanding in finance and solid in marketing, but if your company is stacked with good finance people and very weak on marketing, your highest and best use is probably in the latter. So don't focus just on what you do

If you fill every hour of a daily calendar with meetings or phone calls, you leave little room for dealing with unanticipated developments.

best. You're more likely to succeed if you look around and gauge how you can be most useful.

Many executives also spend too much time on operational details, such as the best flight to take or the seating plan at a corporate dinner. Such tasks should be delegated, if possible, to an executive assistant. Of course, the boss must be able to rely on this person to get the tasks done correctly, quickly, and politely. Once confidence is established, he or she should go to great lengths to support and retain such an assistant, who is crucial to being productive.

PRINCIPLE 2

It's Not the Time You Spend But the Results You Produce

Most executives, professionals, and entrepreneurs put a huge amount of time into their jobs. In a crisis it may be necessary to burn the midnight oil, but the ambitious have a tendency to stay late every night. This tendency arises from the implicit assumption that more hours equal more value added. That is too simplistic. Your success should be measured by the results you produce, not the number of hours you log.

When I joined a law firm in Washington, DC, I soon realized that charging clients for the number of hours worked made no sense. That billing method encouraged lawyers to work lots of hours rather than to get good results quickly. After a few years, my clients knew that I was efficient, so I ran an experiment. I sent them a letter explaining that in the future I would bill them for double the time I actually spent on their work—unless they objected. Not one client did.

Focusing on results rather than hours has the added benefit of allowing a better balance between family and work. When I had young children, I came home most weekdays at 7:00 to have dinner and spend some quality time with them. Later in the evening, if necessary, I would work in my home office. On the weekends my children usually slept late, so I would work from 7:00 to 11:00 in the morning and have most of the day left to be with my family.

Of course, work and home lives sometimes conflict, but that can often be managed. For example, I was working at the Securities and Exchange Commission when mortgage-backed securities started to become big, in the 1980s. There was an intragovernmental task force on the subject with staff from the SEC, the Treasury, and the Fed. I was asked to head part of the task force, which was supposed to meet from 6:30 to 8:30 several nights each week in order to avoid interference with the agencies' normal work. I said, "Well, I'm sorry, I won't be able to do it." They asked why. I said, "Because I go home and have dinner with my kids." So they scheduled the meeting for 5:00 to 7:00—which, of course, didn't interfere with the day's work.

PRINCIPLE 3

Think First, Read or Write Second

Many people feel overwhelmed by the huge volume of reading and writing they have to do for their business. They don't realize that the key to faster and more effective reading and writing is more-rigorous thinking in advance.

I'm not talking about reading novels for pleasure. I'm talking about the mound of business material that piles up on your desk and clogs your computer. To be a speed reader, you have to be very clear in your own mind about why you are reading. For example, in reading the *Financial Times* after the *Wall Street Journal,* I am looking for international issues not covered by the *Journal.*

Here's an exercise I used with my children and nephews. When I saw them doing dense reading in a history or science textbook, I would ask, "When you get to the exam in a month or two, what do you want to remember from this chapter?" Then I'd say, "After reading this chapter, please write no more than the one or two paragraphs you want to remember for the exam. Then go back and see how you could read more efficiently to obtain that paragraph or two."

With e-mails, the first thing to do is to decide which ones need to be read. Second, if any of them are important, I try to answer them right away. If I can't, or they have lengthy attachments, I have them printed out. The next morning I have hard copies of them on my desk and know what I need to respond to.

When it comes to writing something longer than an e-mail, the key is to first figure out your argument. If I don't fully understand my line of argument, I cannot write even a paragraph. To do this, compose an outline before writing. For an article or a memorandum, that means just four or five key points with a few subpoints under each. I've seen many executives realize what they wanted to say only after they had written a lengthy draft. That is unfortunate. You should know where you will end up before you start.

Try this: After composing an outline, write the concluding paragraph. That will tell you whether you really know where your article or memo is going.

PRINCIPLE 4

Prepare Your Plan, but Be Ready to Change It

Most executives must give talks to various groups. They often prepare by writing out the full text of their remarks. But that makes them feel compelled to deliver the whole speech even if the audience is not receptive. Speaking is very different from

writing. You need a much clearer line of argument, and you have to connect with your listeners at a given time. They may be bored or excited—you won't know in advance. To prepare for a speaking engagement, you should jot down on one page a list of your four or five key points and a concluding paragraph. Then try to arrive early enough to hear the prior speaker or to chat with people during a break. That will allow you to grasp the mood of the audience and tailor your four or five points to its state of mind.

I once spoke after James Carville, the Democratic political consultant. He is a folksy raconteur with a wicked set of jokes about his childhood in Louisiana. The crowd was in a boisterous mood after Carville's speech, so I introduced myself as "Billy Bob" Pozen and the audience exploded with applause and laughter.

The same approach can be applied routinely at work. I'm a big advocate of preparing in the evening for the following day. In reviewing each item on the schedule, I'll write down a few words about what I want to accomplish. I'll also compose a list of tasks in order of priority. At the end of the day I'll review what I've gotten done and decide what I need to do in the future. However, I often have to revise my schedule as events progress. Sometimes a meeting is canceled or added, or I'm asked to comment on a news show. So I just revise my to-do list and reset my priorities.

Many top executives fill every hour of their workday calendars with meetings or phone calls. That leaves little room for dealing with unanticipated developments. I try to keep at least one hour open each day so that I can respond quickly to new events or issues.

PRINCIPLE 3

Let Others Own Their Space

It is important to be flexible not only in your own plans but also when listening to your employees. Many executives begin meetings in a directive manner: "This is my view about where this project should

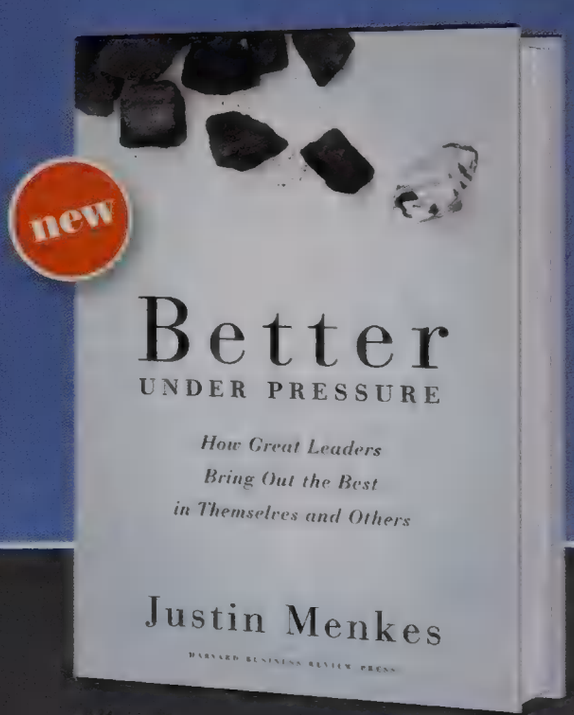
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EXERCISE

With exercise, the key is actually doing it. Many successful people have a daily routine that involves running, biking, swimming, or fitness machines. I am bored by such activities, so I play doubles tennis two or three times a week.

It's easy to skip your workouts when traveling. The facilities may not be good, or your schedule may be too tight. But those are the days when you need exercise the most.

HEALTHFUL EATING

Similarly, it's easy to break healthful eating habits when you're on the road. I know a private equity executive who puts on 10 or 15 pounds every time his firm raises a new fund. Here are three tips for avoiding this fate: Follow your normal breakfast menu even at breakfast meetings. Avoid all desserts at lunch or dinner events. And try to limit alcohol, which is quite caloric, to one glass of wine.

SLEEP

Finally, let me give a sermon on the importance of sleep. Some executives say they can get along on four or five hours a night, but I doubt they are as mentally sharp as they could be. Seven or eight hours a night, plus a brief nap during the day, will make your waking hours far more productive.

Again, it can be challenging to stick to this routine when on the road. Evening flights from the East Coast of the United States to Europe last only six or seven hours, so I eat before getting on the plane and go right to sleep as soon as I'm in my seat. The key to sleeping on planes is a blindfold and earplugs, which create the sense of being in a cocoon, cut off from the rest of the world. This feeling is easier to create in a window seat than in an aisle seat, where it's hard to avoid the commotion of the plane's staff.

head. And here are the key steps I believe we need to take." That gives a meeting focus, but it may also discourage participants from voicing concerns.

I take a different approach—the rebuttable hypothesis, which is designed to encourage debate. I might say, "Here is the area where we really need to do something. It is a difficult area, and there are several ways to address the problems. Now, this is my tentative view of the path we should take, but I could be wrong. I want you to feel free to disagree and offer alternatives." Then I have to be willing to discard or modify my hypothesis if someone comes up with a better approach.

At the end of a meeting I will always ask, "What are the to-dos, who's going to take care of them, and when will they be delivered?" I want the participants to agree on the deliverables and to set their own timetable. Then they will have an ownership interest in the follow-up, rather than just going along with my directions. And they often select a more aggressive timetable than I would have had the nerve to suggest.

More broadly, I've become messianic about the general principle that people should own their own space. Under this principle, every employee in a large company is viewed as the owner of a small business. The boss's role is to provide reports with resources, give them guidance, and help them do battle with other people in the broader organization.

You can reinforce the principle of ownership in many ways. For instance, instead of assigning detailed tasks, you can present general priorities for the upcoming year and let your reports formulate specific ways to implement those priorities along with the metrics for measuring success.

When you apply this principle, you must be prepared to tolerate mistakes. If employees own their unit, they must be given leeway to try out new strategies. That invariably means that they will sometimes drive to a dead end or incorrectly assess a market's potential. If you

I try to keep the material aspects of life as simple as possible. I eat the same thing for breakfast every morning—a banana and a bowl of cold cereal.

fire them for making such mistakes of judgment, you will undermine the culture of ownership. Of course, your tolerance for mistakes should not be unlimited. You should not ignore illegal or unethical actions. Nor should you tolerate repetition of similar mistakes by the same people. One of my favorite sayings is, "Let's make a new mistake."

PRINCIPLE 6

Keep Things Short and Simple

On a daily basis, I try to keep the material aspects of life as simple as possible in order to maximize productivity. I get up every morning around 7:00 and have shaved, showered, and dressed by 7:15. Then I read two newspapers while having breakfast and leave home around 7:30. The night before, I set out what I'm going to wear. I have five winter outfits and five summer outfits. And I eat the same thing for breakfast every morning—a banana and a bowl of cold cereal. I'm very boring in the morning.

For lunch I have a chicken salad sandwich and a diet soda, unless I'm attending an outside event. I try to take a nap every day after lunch—I just close the door, put up my feet, and I'm out like a light for almost exactly 30 minutes. I feel refreshed and energized for the rest of the day. When I'm on the road, I usually have meetings at breakfast and lunch, but I still try to sneak in my afternoon nap.

I also have a travel routine. I take the same carry-on bag with a prepacked plastic bag of toiletries. That bag fits on overhead racks, but it's big enough to carry clothes for four or even five nights away. I carry a canvas bag instead of a briefcase, because it's lighter and holds more. In that bag I keep my passport, a set of pens, a blindfold, and earplugs. Plus I have a little flashlight, so if I'm in a taxi and the light is bad, I can still keep working.

The keep-it-simple rule applies equally well to other aspects of work life, such as meetings. Almost any meeting can be completed in an hour or at most an hour and a half. After 90 minutes, people turn off—they get tired and stop paying attention.

The presenter at a meeting should circulate materials in advance to all participants. These should always include a one-page executive summary, and the explicit norm should be that everyone reads at least the summary before attending the meeting.

In a productive meeting, the presenter takes five or 10 minutes to set the stage and tee up the key questions. That leaves the rest of the time for discussing issues and formulating an action plan. But we have all attended unproductive meetings. We sit quietly and politely as the presenter reads every word of 20 or 30 PowerPoints—many of which were included in the advance materials for the meeting. Instead, after the first 15 minutes of slides, we should collectively rise up and exclaim, "We're as mad as hell, and we're not going to take this anymore!" Wasted time and effort are the ultimate productivity killers. They should not be tolerated.

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Robert C. Pozen is a senior lecturer at Harvard Business School and a senior fellow at the Brookings Institution. His most recent book (with Theresa Hamacher) is *The Fund Industry: How Your Money Is Managed* (Wiley, 2011).



"I'm reluctant to fire him until we at least figure out what he does here."

Crucible

Transformative events that shape leaders



Forced to Shut Down

What a Chinese travel entrepreneur learned from the SARS crisis and its aftermath

by Alison Beard

The first defining moment of Zhang Mei's career came in late 1999, when she quit her lucrative consulting job to launch a small travel company in her native China. In December, the Harvard MBA was wearing business suits to New York boardroom meetings; by July, she was in jeans, on the floor of her tiny Beijing office, untangling telephone wires.

The second—and more important—turning point came nearly four years later, when the SARS (severe acute respiratory syndrome) outbreak hit Asia, battering a travel industry still recovering from the 9/11 terrorist attacks and all but killing Zhang's fledgling business. Nothing in her training had taught her how to handle the crisis. But she managed to keep the company going, and today WildChina is a leader in its field.

Looking back, Zhang sees that her first big move turned her into an entrepreneur. But it was the SARS experience that taught her how to be a CEO.

"I had high hopes for the business," she recalls, "and early on I wondered: Am I a good manager? Am I a smart leader?"

After 2003, however, she was battle tested: "These extraordinary events happen once in a decade, and I'm lucky I got mine early."

A New Direction

Zhang grew up in Dali in China's Yunnan province, studying English at the insistence of her father, an electrician who'd never attended high school. She went to Yunnan University and then worked as a translator, until a Thai banker she had met at a business event encouraged her to apply to Harvard's MBA program—and promised to pay her tuition if she would join his company after graduation. Once enrolled, she set her sights on a corporate career—"doing the job while other people took care of the details"—and was thrilled to land at McKinsey, in a position that required extensive travel and allowed her to repay the banker rather than work for him.

But consulting left her unfulfilled. She wanted more freedom and even more travel. She also wanted to do something good for China. McKinsey gave her a pro bono assignment: strategizing on economic development and conservation in Yunnan province on behalf of the Nature Conservancy, a U.S.-based NGO. Zhang liked nonprofit work but didn't want to make a career of it. Instead, she came up with a business idea: Launch a travel company to offer sustainable, socially responsible tours of Chinese destinations and communities.

She did a test run, guiding two Nature Conservancy executives and two *Washington Post* journalists into Tibet—impressing one of them so much that he soon married her. And then Zhang made her move, relocating to Shanghai and taking a job at travel website Ctrip to learn the industry while honing her business plan. A few months later, armed with her own savings and small investments from friends and family, she joined her new husband in Beijing and launched WildChina.

"I had no idea what I was doing, and I never perceived myself as a salesperson, but I became really good at selling my idea—to investors, staff, clients," she says. "I didn't even mind all the mundane details of entrepreneurship at the beginning—moving the table and buying the trash can. I just had a conviction."

With a small, young, enthusiastic staff, a growing list of mainly American clients, and tours focused on everything from city hopping to bird-watching, the company turned a profit in its first year. Then came the travel standstill following 9/11. "She was definitely thinking the business might be finished: good idea, bad timing," recalls Zhang's husband, John Pomfret. But the slowdown ultimately served as an impetus to improve her strategy. "Our business had been focused on U.S. travelers, and that was the first time we started thinking about selling in other markets as well," says Guido Meyerhans, a McKinsey colleague who had invested in WildChina. By early 2002, bookings were back on track. Still, the experience didn't fully prepare Zhang for the next, more painful crisis.

Second Shock

The first reports of a deadly SARS outbreak in China's Guangdong province, about 1,400 miles south of Beijing, emerged in February 2003. In March, the World Health Organization issued a global alert, and foreign countries started to release travel warnings for China. But in part because Chinese officials were claiming to have the situation under control, Zhang and her employees carried on as usual. "It was peak season, clients were still coming, and the news was all about how limited the SARS cases were," she recalls. "So we didn't make any contingency plans."

By April, however, cancellations were pouring in, and, late that month, Beijing was declared a danger zone. Zhang thought she could finish up the tours in progress and then redirect her staff to planning and training until bookings resumed. "Then one day," she recalls, "the contractors renovating our office said, 'We can't come in.'" They didn't want to risk infection by riding the bus. "That's when it dawned on me: This is serious."

Belatedly, Zhang and her COO, Jim Stent, started to consider the threat to their own employees, to cancel all trips already under way, and to develop models of what a pandemic might do to their balance sheet. Staff salaries were low by Western standards but could still have eaten up the company's reserves within six months in the absence of new revenue. Zhang wanted to buy herself at least a year, so she opted for drastic measures: WildChina would cease operations immediately. Both she and the COO would suspend their incomes indefinitely. The dozen or so other employees were asked to forgo 75% of their income until the fall, essentially taking vacation at 25% pay. Once the company reopened, if it did, everyone would be fully reimbursed. They all agreed.

Zhang opted for drastic measures: WildChina would cease operations, she and the COO would suspend their incomes, and all other employees would go on vacation at 25% pay.

Jia Liming, Zhang's first hire at WildChina, remembers ending the long-planned bird-watching trip she'd been guiding a week early and then attending an employee farewell party—held at a Beijing park since the SARS threat was considered to be less severe outside. "We thought it was over," she says.

For her part, Zhang remained calm. But "it was hard to stomach," she says.



WildChina employees attend a farewell party at a Beijing park in the summer of 2003, at the height of the SARS outbreak.

"The city was in lockdown, and it seemed like the whole world was coming to an end. Still, I'd been through 9/11, so I was confident we could come back."

Indeed, by midsummer, following more than 8,000 cases of infection and nearly 800 deaths, SARS seemed to have been contained, and bookings began to pick up again. Zhang and Stent decided to reopen much earlier than they'd expected, on August 1, and called back all the staff.

But it wasn't as easy as that. Zhang's top performer in terms of sales and customer service—a young woman she'd hired in 2001 and come to view as a protégé—refused. "She said she wanted more time to hike around another mountain," Zhang says. "I said no. I'd promised a client a proposal by August 5. Two weeks later, she didn't show. Eventually she came back, all smiles, and I had to tell her I'd given her position away."

The woman soon launched a regional competitor to WildChina, and over the next few months several other employees left because they missed traveling independently. "It was disappointing because she'd paid these people well and given them opportunities," Pomfret says.

The next few months at WildChina were nose to the grindstone—reaching out to new clients in the corporate and education sectors; selling, planning, and executing trips; recruiting and training new employees; and replenishing the reserves to pay employees' back salaries and fund growth. "We had to hustle," Zhang says. But it paid off. "2004 was one of the best years we've had, in terms of profits and new projects."

Seasoned Traveler

Today, "a little bit older, a little bit wiser"—and having stepped down as CEO in late 2004 to follow Pomfret to the United States, where he had a new job—Zhang points to a few ways in which the SARS crisis helped her become a better leader.

First, it taught her the importance of scenario planning and proactive communication with staff and customers in crisis situations. "I was responsive to client questions during SARS," she says, "but I didn't take action until May, by which point I was a little bit cornered." Since then, WildChina has established crisis response guidelines. "Number one is to make a judgment call as early as possible,"

> Zhang realized she needed to think harder about whom she was recruiting and why.

says Zhang, who remains chairwoman and part owner and oversees marketing from her suburban Maryland office. When riots broke out in Tibet during the 2008 Beijing Olympics, for example, the company issued a press release and sent instructions to staff and guides the next day. Meyerhans notes that employees are also in closer contact with provincial government officials to ensure access to the most accurate information. "Once you start preempting clients' questions, they feel you're in control," Zhang explains.

The employee fallout from SARS was also educational. When people Zhang had trusted left her, she realized she needed to think harder about whom she was recruiting and why. In the first years of WildChina, she explains, "I was looking for the passionate, free-spirited traveler. I should have been looking for the customer service, travel industry professional—someone who really gets satisfaction out of serving other people." She was also giving promotions and pay raises too quickly, on an ad hoc basis, without establishing benchmarks for advancement, including long-term commitment to the company.

After SARS, Zhang built a different kind of team, including more-seasoned managers who could handle day-to-day operations when she left in 2004. "One of her biggest achievements," Meyerhans says, "was making that transition so smoothly, based on the trust she had in the employees she'd hired."

More broadly, he thinks the two early hits of 9/11 and SARS forced Zhang to be a more creative, confident executive, diversifying and expanding the company each time. "We had high-net-worth individuals and small groups, but that's a difficult business to control and grow, so we started to build up the corporate and the educational business," in addition to targeting different geographic regions, he explains. And Zhang has insisted in the years since that WildChina stick to that forward-thinking strategy. During the recent financial crisis, for example, even as competitors retrenched, "I doubled down," she says. "I plowed more than 50% of our profits into marketing and IT. I knew that China's rise, and its tourism and our business, would outlast the recession."

One last benefit of enduring the SARS period, with no income, was that it reinforced Zhang's passion for her venture. "You go through self-doubt moments," she recalls. "When the profits aren't great, you say, 'Wow, how did I labor another year with no payback?' But I'm in this because I enjoy it. As long as I have a comfort level that reaches the minimum threshold, I can seek satisfaction in other areas, like social impact. I don't want to go back to consulting." ▽

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Alison Beard is a senior editor at *Harvard Business Review*.

PHOTOGRAPH: COURTESY OF ZHANG MEI

Innovation and the Cloud

Emerging from the recession, many companies are talking about the need to focus on innovation in a new way. What's changing—what has to change?

Everyone *says* they want to innovate. But actions speak louder than words. Always. Too often, executives view innovation as complicated, time-consuming initiatives that will undermine focus. They hold legacy perspectives of innovation as something that requires too much of their time, too much money, too many people, and too much risk. Technology has made that kind of innovation mind-set anachronistic and obsolete. Today's digital technologies let you find secure, flexible, fast, and fairly inexpensive ways to test many ideas without huge commitments. The cloud dramatically reduces the barriers of entry to meaningful innovation actions.

The cloud creates what we might call "accordion innovation": you can try something small, test it at larger scales, and then bring it right back down to study what you learned. You can customize the scale as easily as you can customize your test. We've gone from the cloud only meaning software as a service to incorporating more open-ended platforms that provide scalable experimentation. That's huge. That deserves C-suite attention. Then again, the cloud facilitates bottom-up experimentation and innovation just as readily as it empowers top-down innovation initiatives.

That's why exploring innovation in the cloud is so important. Many organizations aren't designed to be agile, adaptive, and responsive; they are kind of muscle-bound in their processes, and their systems don't lend themselves to agility. They emphasize optimization over innovation. The cloud provides an environment, a playground that enables "just in time" innovation on many fronts—rather than over-rely on thumb-sucking, let's-wait-until-we-get-it-perfect analysis.

How does the cloud create climate for this kind of ongoing experimentation?

The cloud creates innovation climates where what used to be time-consuming and resource-intensive is now pretty quick and surprisingly easy. The evolving architecture of the cloud makes exploration and experimentation friction-free compared to more traditional IT infrastructure. Plug-and-play interoperability gives you the ability to quickly and easily write mash-ups that can create new data, information, and processes. Instead of dreading the idea of connecting disparate software and systems, people can get excited about the opportunity. And decoupling systems is as easy and convenient as coupling them. The economics of experimentation become friendly. You don't need huge investments to get huge results. In fact, if you're making huge investments, you're probably doing something wrong. You can quickly launch lightweight, high-impact experiments that allow you to manage innovation risk faster and safer.

There is increasing emphasis on the need for collaboration—inside and outside the organization. How do the new technologies facilitate that?

I am someone who believes that collaboration—like innovation—is a means to an end. We innovate because we want our innovations to both sharpen and amplify our strategic intent. We collaborate because we believe that we can deliver more value or more efficiencies working well with others than doing it all by ourselves. When organizations decide what principles and practices collaboration should be built on, there is no better medium for enabling them than the cloud.

The world-class organizations I've observed and work with make the cloud a medium for shared space. The cloud is where vendors can virtually interact around models, prototypes, or simulations of product and process simulations. Digital versions of documents or dynamic representations can be tracked, managed, and evolved. You see this done really well with computationally-intensive CAD/CAE-driven firms—or companies confronting ever-larger data-sets for analytics—that have to deal with spikes and surges in demand.

Again, the interoperability architectures of the cloud—the fact that the standards and APIs are public and accessible—make the economics of creating, sustaining, and exploiting these shared spaces friendly and accessible. This is so beyond email plus attachments that it's not funny. The cloud is a place for interaction, not just transmission; collaboration, not just exchange of information.

Just as we've seen the consumerization of enterprise IT with the influence of the Internet and digital devices of all kinds, we're seeing the cloud enables a richer variety of enterprise collaboration services—that teams and their leaders can scale, accordion-like as demand requires.

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Case Study

W. Earl Sasser (wsasser@hbs.edu) is a Baker Foundation Professor and the chair of the Program for Leadership Development at Harvard Business School.

A rising-star executive calculates his response to a hypercritical superior. *by W. Earl Sasser*

Challenge The Boss or Stand Down?

The Experts



Jeffrey Pfeffer is the Thomas D. Dee II Professor of Organizational Behavior at the Graduate School of Business, Stanford University.



Paul Falcone is the vice president of human resources at Time Warner Cable.

Thomas Green winced as he reread an e-mail message from his new boss, Frank Davis, marketing director for the travel and hospitality group at D7 Displays. "Tom, this week's client meetings went well, but they would have gone better if you had been on top of the market data," it read. "When you're on your own, I expect you to be better prepared. It's essential for your new responsibilities in developing market strategies for your region."

Tom looked up from his paper-strewn desk and glumly surveyed the view from his new 20th-floor office in midtown Atlanta. Just a few months ago he was the company's fastest-rising star, promoted, he thought, to bring fresh thinking to the firm's self-service kiosk business. He'd catapulted from account executive to his new position as a senior marketing specialist, bypassing colleagues and collecting a 50% raise. And hardly six weeks later, he was being lectured—again—about how to win a sale. Unless he could get a handle on his new boss, Tom figured he'd be lucky to make it to his one-year anniversary.

A single rap on the door snapped Tom out of his reverie. Frank Davis immediately let himself in.

"Taking a break, Tom?"

"No, Frank," Tom replied coolly. "I was thinking through my kiosk-services development project. If we can't get new offerings out there soon, we won't be able to compete in this business. I know you're not a fan of the project, but—"

"Did you read my e-mail?"

"Yes, I did."

"And?"

"And, yes, I will prepare better."

"Good," Frank said. "And, Tom, I need you to put your skunk works project on hold. The market-strategy meeting is next week, and I still haven't seen your plan, which was due yesterday. That is your one and only priority right now. *Capisce?*"

"Understood," Tom said wearily.

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "Thomas Green: Power, Office Politics, and a Career in Crisis" (case no. 2095), by W. Earl Sasser and Heather Beckham. It is available at **hbr.org**.

The Tricky Fast Track

D7 Displays, launched in 1990 as an ATM provider, now dominated the self-service kiosk business. With 1,500 self-check-in stations in 75 airports, the firm had sewn up 60% of the air-carrier market and was making inroads into hotels and car rental agencies. Tom had joined the company just a year before, at age 28, and he immediately set about getting noticed. Within weeks he had secured a contract with a major airline to accelerate kiosk rollout in 20 airports and buy software upgrades across their locations. He'd also worked the back channels to get the ear of his division's software-development director and push his ideas about new service offerings—an unorthodox move that ruffled some midlevel feathers but got senior management's attention.

It was clear to Tom that for the kiosk business to compete with web-based check-in services, increasing penetration wasn't enough. Kiosks had to offer unique advantages to both customers and clients—for example, digital advertising displayed on screens while kiosks are not in use and cross-selling opportunities such as links to travel partners whose services fit the check-in passenger's profile.

At a training session in midtown, Tom hit it off with Shannon McDonald, the division vice president. Both were University of Georgia alums, and Shannon, sensing his potential, made an effort to get to know him. Tom, for his part, instantly realized that Shannon could be his ticket to the fast track. When a senior marketing specialist position opened up for the Eastern North America region, he pounced. During the ensuing month, he made multiple trips to Shannon at headquarters and outlined the client opportunities he saw and his strategies for winning them. She offered him the job over dinner.

Tom vividly remembered that evening. He and Shannon had appeared to see eye-to-eye on the company's imminent challenges. But he particularly recalled her words of caution, which in retrospect seemed especially ominous.

From day one, Tom had felt like Frank was out to get him.

"Tom, you're ambitious and creative," she'd begun, solemnly. "This group needs a fresh perspective, and I'm willing to take a chance with you. But you'll have to learn quickly. You don't have managerial experience, and while you've nailed your sales roles, this position requires you to think strategically as well as tactically—and to work across layers of management. I expect you to seek guidance from some of our seasoned managers."

Tom had assured Shannon that he'd do his best, and he was taken aback by her response.

"I'm sure you will, Tom, but you're walking into a tricky situation with Frank. He has very aggressive growth goals for next year—maybe more than the market data warrant. You'll have to manage that. He'd also expected to choose the new senior marketing specialist—and he would not have chosen you." She paused. "I need you to do better than your best."

Um, That Went Well

By the time Tom found the room for the strategy-planning meeting, the rest of the 12-person senior sales and marketing team had already assembled. Catching his breath, he squeezed in at the long oval table, planting his iPad before him.

"Glad you could make it, Tom," Frank began. After a deliberate pause, he continued. "Welcome, everyone. We'll be reviewing sales projections for the coming year, performance expectations for the senior marketing specialists and their teams, and overall strategy for meeting those. We've realized a 10% CAGR over the past five years, and corporate expects this division to continue to be a growth engine. Before I walk through the detailed analysis, let me give you the executive summary." Frank projected a slide showing a U.S. map with each of the company's five sales regions. "Given the market opportunities in the Eastern region, Tom and his team will have the most-aggressive growth targets—15% for the airline, hotel, and car rental markets combined. Next, the South Central region—"

"Frank?" Tom interrupted. "There's no way we can achieve double-digit growth this year."

"Excuse me?" Frank responded, astonished. The room was silent.

"It can't be done with our current offerings. I was with clients in New York, Boston, and Orlando last week. Airline kiosks represent a mature, saturated market. The airlines are hurting, and they're flocking to competing web-based check-in and asking why they should keep buying an outmoded product that's expensive to install and maintain. Web services do the same thing but cheaper."

Frank took a deep breath. "Tom, most of our revenues come from the airlines market. But hotels and car rental agencies are wide open: 15% and 5% of revenues, respectively. As we've discussed," Frank continued, enunciating each word, "you'll be pushing into those markets. That's where the growth will be."

Tom spun his iPad so that everyone could see it. "Before the meeting I checked in through this web service for my flight this afternoon to DC. It was almost too easy. It doesn't require hardware installation, maintenance, or expensive proprietary-software upgrades. The only way our kiosks can compete is for us to develop kiosk-based services that generate revenue for clients or offer other benefits web services can't. The writing's on the wall."

"Tom," Frank interjected, "I don't seem to be getting through to you. Our client airlines have invested heavily in our kiosk hardware and infrastructure. They won't just pull the plug. If you turn your attention to developing market strategy, you could put kiosks in every hotel and car rental agency in your region."

Tom hesitated but couldn't contain his frustration. "Actually, Frank, I've been out



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there talking with prospects and clients. A lot. Those industries have nothing like the appetite that airlines had in the early years. Hotels are high-touch services: Customers want a human, not a kiosk. Car rental companies need no more than a few kiosks, even at high-volume airports. You're comparing apples and oranges."

Silence. At last, Frank spoke. "As I said, Tom's growth target for the Eastern region for next year is 15%. Now, does anyone object to moving on to South Central? Good."

And That Went Even Better

Tom poked his head in Frank's door. "You wanted to see me?" He knew what was coming. From day one, he'd felt like Frank was out to get him. Yes, sometimes Tom liked to shoot from the hip, but that style had helped him land some big accounts. Unfortunately, it roiled Frank.

"Have a seat, Tom." Tom dropped into a low leather chair facing Frank's desk. "I just e-mailed Shannon McDonald and cc'ed you. Your performance at today's meeting was way out of line. If you ever publicly challenge me again, I'll do more than send an e-mail. But the problem is bigger than bad manners. This job requires more than your sales smarts. You're thinking like a lone-gun account executive when you should be focusing on regional strategy development, teamwork, and clear communication up and down the chain of command. It's not just your attitude; it's your entire outlook."

Frank handed Tom a copy of the e-mail he'd sent to Shannon. "This memo details your shortcomings—and corrective measures for them." Skimming, Tom caught phrases like "poor judgment" and "questionable behavior."

"Tom, I'm going to keep closer tabs on you. You'll inform me of your detailed plans and update me on your schedule on a daily basis. I found out from one of your account execs that you were in New York when I thought you were in Boston—"

"But I was going to tell you!" Tom interjected. "I finished my Boston client meetings early and was able to get time with the software VP at IndiZm in New York to discuss new kiosk services. It's part of the software-development project."

"Yes, but you're off that project now. Your Outlook calendar said you were in Boston, and I got shunted to your voice mail when I called. From now on, you'll update Outlook daily and return messages from the office promptly. I will need to see your specific client-communications strategies before your sales calls, and to review all sales collateral in advance. You will stop making client calls purely to meet people. You'll produce reports by the deadline. Finally, you'll have a more positive attitude both inside and outside the company."

"I don't have a bad attitude," Tom objected. "I'm *trying* to develop our offerings so that web services don't eat us for lunch. Five years ago, only about half of U.S. leisure passengers used web check-in. Do you know what the figure is today?"

> "Your performance at today's meeting was way out of line. If you ever publicly challenge me again, I'll do more than send an e-mail."

Frank narrowed his eyes. "Yes, I'm aware of web competition, Tom. I've been doing this for 20 years. As I said, the airlines won't throw their big investments in hardware out the window, trust me. Next year's growth is in expanding our penetration of the hotel and car rental markets, and that's where you'll focus. After you've made progress there, we can talk about your software project. End of discussion."

As Tom headed down the hall to his office, he muttered under his breath, "I don't *think* so."

Heck of an Outlook

Tom laid low for the rest of the week and considered his options. The lull in Frank's criticism gave him a dim hope that the worst was over. As Tom scanned his Outlook calendar and gloomily considered updating it, he spotted an alarming new e-mail in the queue. It was from Shannon McDonald. cc: Frank Davis. Subject: Performance.

"Frank Davis has explained to me his point of view on your performance," the message began. "I think all of us want to improve the current regrettable situation. Frank has articulated his expectations for your improvement over the next 30 days, after which he and I will re-evaluate your continued suitability for the position. At this point, I would like to get your ideas about how you can improve your performance. Please send a statement in writing within 48 hours so that we can resolve this issue promptly."

Later, as Tom drove his E82 coupe north on Peachtree Street toward his new condo in Buckhead, it seemed unwise to have bought a car and house so soon. Frank wasn't merely whining about Tom's style; he appeared to be building a by-the-book case for firing him.

Tom could envision only two scenarios for staying with the company: (1) Do as he was told, change his style to suit Frank's agenda, and execute on a strategy he believed was flawed; or (2) expose the full extent of Frank's dubious projections and strategy to Shannon, his original sponsor, and hope she'd rescue and redeploy him.

As Tom fought his way through the rush-hour traffic, he kept coming back to the only thing that was certain: It was a hell of a time to be out of work.

How should Tom respond to Frank's demands?

See commentaries on the next page.

The Experts Respond



Jeffrey Pfeffer is the Thomas D. Dee II Professor of Organizational Behavior at the Graduate School of Business, Stanford University. He is the author of ***Power: Why Some People Have It—and Others Don't*** (HarperBusiness, 2010).

THOMAS GREEN faced a set of predictable problems that he failed to forestall. Instead of further poisoning his relationship with his boss by seeking to "expose" him, Tom should now start to repair the damage he's done to both his professional relationships and his career prospects.

Tom's first mistake was in neglecting to consider that he was not his boss's choice for the position of senior marketing specialist. From the outset he should have recognized the significance of that initial strike against him and, therefore, should have made it a top priority to earn Frank's trust right away. But he did just the opposite: failing to deliver an important report on time and not keeping Frank informed about his work in general. Most glaringly, he challenged his boss's authority publicly. Tom may believe that hierarchy doesn't matter so much in today's corporate world, but bosses still love the sort of deference that validates their status.

Tom's second mistake was in assuming that merely articulating his impression of the competitive threat from web-based offerings would immediately change the minds of his boss and others in the organization. Tom spent virtually no time building the close social ties with people that would give him the credibility to convince them of his perspective. For example, after his promotion, Tom didn't brief Shannon on what he had learned and accomplished in his new role. She had no way of knowing about the contributions he was making and thus had little reason to continue to support him. Her only information about Tom was the negative feedback she had been seeing from Frank.

> Tom needs to spend more of his time managing up if he wants to avoid getting managed out of the company.

Fortunately, it's not too late for Tom to repair this damage, although he must act quickly. He should start by apologizing to Frank for challenging him in public, then follow up by doing exactly what Frank asks and keeping him in the loop on all developments. Tom should also apply the power of flattery, which research shows is all but impossible to overuse. He should acknowledge Frank's many years of experience and ask for his assistance in thinking through the competitive challenge that web services present to D7 Displays. Asking for help not only secures it, but also flatters the person being asked.

Finally, Tom must reconnect with Shannon in a carefully considered way. He should set up an in-person meeting with her rather than respond in an e-mail (which could be forwarded). In that meeting Tom needs to apologize for the problems with Frank and for not keeping Shannon adequately informed about his efforts, including learning about the competitive challenges facing the company and building new customer accounts. He should ask her to be his mentor, especially in working effectively with Frank. This outreach is likely to rekindle Shannon's support for Tom.

Companies are social systems made up of individuals whose self-esteem must be taken into account. Tom needs to spend more of his time managing up if he wants to avoid getting managed out of D7 Displays.

WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

TOM SHOULD find a way to creatively meet the boss's expectations and increase market growth to 15%, if not 18%. That will earn Frank's respect and allow Tom leverage to do his job his way in the future.
Cynthia M. Powell, *graduate student, Vanderbilt University*

I'VE BEEN a Tom, but I handled it differently. I completely disagreed with my boss, but before any public discussions or actions, I asked to see him in person. He saw me as loyal yet strong enough to face the big bear.
Joel Stock, *president and CEO, Westmont Corporation*

TOM IS doomed and should begin to look for another job immediately. People like Frank run good businesses into the ground because they can't adapt to change. Frank is too wrapped up in himself to admit he may be wrong.
Stefani Schow, *stay-at-home mother; former publishing supervisor, Robertson Stephens*

THE REAL mistake here is Shannon's. She should have let Frank interview Tom before he was hired. Then Frank would feel more in charge of Tom and would not have to show him who is boss.
Adam Ibrahim Salem, *corporate director of finance, B & G for Hospitality Business*

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Paul Falcone is the vice president of human resources at Time Warner Cable. He is the author of ***101 Tough Conversations to Have with Employees*** (Amacom, 2009).

TOM NEEDS to ask himself what he believes is right and then follow his heart. It doesn't make sense for him to be blindly obedient if he is unshakably convinced that his boss Frank is sending him and the company in the wrong direction. That does not

Trying to pit Shannon and Frank against each other will surely backfire.

mean, however, that his only alternative is to expose Frank's supposed incompetence. Tom has more options than the two he lays out for himself. It's not an either/or proposition.

First, let's look at what isn't an option. No one wants to explain having been fired to a prospective employer, so Tom needs to make every effort to avoid termination. At the top of the list of steps he can take is to abandon the ill-conceived notion of going over Frank's head to Shannon. Her e-mail to Tom reveals why that's a bad idea: "Frank has indicated to me his expectations for your improvement over the next 30 days, after which *he and I* will re-evaluate your continued suitability for the position." Shannon is obviously taking up ranks with Frank on this one, and trying to pit them against each other will surely backfire on Tom, especially given Shannon's earlier warning that he would have to manage his relationship with Frank.

There are plenty of Franks out there, and they may get tougher to handle the higher up the ladder Tom goes. As he runs across other bosses with whom he disagrees, he can still identify ways to work effectively with them. If he wants to pursue a corporate career path, Tom will need to find humility within himself as he advocates for his point of view and builds support for it.

It shows a striking lack of business maturity for Tom to assume that he'd outthought Frank, who has 20 years of

Tom may want to leave his job at D7 Displays before he is terminated.

experience, or that he has superior market intelligence because of a few recent conversations with clients. If Tom wishes to stay at D7 Displays, he will need to develop—and then demonstrate—maturity by extending an olive branch to Frank and following his guidelines to a T.

That said, not everyone is cut out for corporate life, and Tom ought to carefully examine his suitability for a career path that often will require putting the needs and preferences of bosses and the organization above his own. If he thinks he will be unable to cultivate the humility, selflessness, and patience that are required for corporate teamwork, he may want to leave his job at D7 Displays before he is terminated. Perhaps he will choose to pursue a more entrepreneurial course that will allow him the space to call his own shots.

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TOM CAN'T change his boss; he can only change himself. If Tom wants to succeed in his new job, he needs to forget about what anyone else "should" do and focus on his own actions.

Dorothy Nesbit,
director and leadership coach, Learning for Life

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Blue Ocean Fiction

Why do American novelists and short-story writers avoid the contemporary workplace? *by Katherine Bell*

Americans, we're told, work more than our counterparts in any other postindustrial nation. Many of us spend more time with our coworkers than with our families. Our jobs define our lives. And yet our writers of fiction—those whose job it is to chronicle and interpret what occupies and preoccupies us—hardly ever venture into the offices we inhabit.

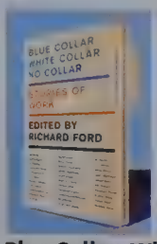
The business world is strangely absent from *Blue Collar, White Collar, No Collar: Stories of Work* (Harper Perennial, 2011), an anthology of short fiction from the past 50 years, edited by the novelist Richard Ford. Of the collection's 32 stories, barely a handful offer protagonists with office jobs, and work figures peripherally in most of those. Only one—Richard Yates's "Glutton for Punishment," the most affecting story—centers on corporate employment, and the main character is fired on page four.

For the best insights into the experience of working with others—the trading of power, the risks of familiarity—the reader must turn to stories about a priest and his housekeeper, a grocery clerk and a shop owner, and a pharmacist and his assistant. In "The Store," for example, Edward P. Jones captures the near-universal daydream of making oneself indispensable and then quitting:

> I didn't think Mrs. Jenkins was the kind of woman who would beg me to come back, but I did like imagining her sitting on her high stool, reading her damn paper and thinking of what a good worker she had lost...And a thousand times...I promised myself I would give her a week of work... and then, come Saturday night, get my pay and tell her to kiss my ass. But always there was something...to bring me back on Monday.

In recent years American television has dealt with fictional corporate life more successfully than literature has, in two genres: the comic (*The Office*) and the tragic (*Mad Men*). *The Office*'s writers capture with wry precision the peculiar intimacies, betrayals, and longings of the modern workplace, while *Mad Men*'s creators treat relationships among its firm's employees as seriously as those between spouses and find cultural resonance in the work of advertising itself, despite—or because of—the decades-long gap between the story and its telling.

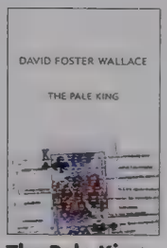
Our most recent boom-and-bust cycle brought on a rash of satiric novels about U.S. corporate life. *Then We Came to the End* (Little, Brown, 2007), by Joshua Ferris, and *Personal Days* (Random House, 2008),



Blue Collar, White Collar, No Collar: Stories of Work
edited by Richard Ford
Harper Perennial, 2011



Union Atlantic
Adam Haslett
Nan A. Talese/
Doubleday, 2009



The Pale King
David Foster Wallace
Little, Brown, 2011

by Ed Park, are two raucous, piercing tales of employee attrition. But there's been much less in the dramatic vein, even though the Great Recession's effect on both the grand sweep of capitalism and our intimate working lives is one of the most gripping and revealing stories of our time. One ambitious novel, Adam Haslett's *Union Atlantic* (Nan A. Talese/Doubleday, 2009), chronicles the fall of a futures trader, along with his bank. The problem is that

> "Fiction elevates...what we might've thought we already knew...and focuses a new gaze upon the matter."
> Richard Ford, *Blue Collar, White Collar, No Collar: Stories of Work*

neither the bank nor the bankers come alive as believably as the novel's other places and characters do.

So why isn't more—and better—serious fiction about the contemporary corporate workplace published?

Hypothesis 1: Writers are taught to write what they know, and they don't know much about having a regular nine-to-five job. This explains why the workers in several of Ford's chosen stories are writers or editors and why so many characters in other contemporary fiction are professors (usually in the humanities); journalists, as in Tom Rachman's *The Imperfectionists* (Dial Press, 2010); or art-industry professionals, like the gallery owner in Michael Cunningham's *By Nightfall* (Farrar, Straus and Giroux, 2010)—or they don't have jobs at all. But the stick-to-what-you-know adage is itself a fiction. By definition, novelists are supposed to bring to life situations they haven't experienced firsthand. Surely, it's harder to write about characters in different centuries or countries than in different occupations?

Hypothesis 2: The details of contemporary work are too complex to explain elegantly without getting in the way of the plot. So contends John Lanchester in the UK's *Telegraph:*

> Television can give us a cartoon version of...work; for a fuller and more real version, the writer would have to do a huge amount of explanation of the complex realities of... working lives. But you can't explain in fiction, not like that and not at the necessary length.

Modern cities, warfare, and marriage, however, are also complicated, and novelists manage to write convincingly about them.

Hypothesis 3: Corporate life is boring. Readers who toil in offices all day don't want to read about work in their off-hours. This might be a compelling argument if so much of contemporary American fiction weren't obsessed with the excruciating minutiae of suburban family life or if workplace relationships weren't equally fraught and fascinating. It is true, though, that corporate settings present two practical problems for writers not aiming for satire: cliché-ridden language and standard-issue furnishings.

Try reading Ford's explanation of a character's job, in the archly titled story "Under the Radar," without skimming:

> Steven's job at Packard-Wells was to stay on top of a small segment of a larger segment of a rather small prefabrication intersection that serviced the automobile industry, and where any sudden alteration, or even the rumor of an alteration, in certain polymer-bonding formulas could tip crucial down-the-line demand patterns.

And here is Ann Beattie, trying to be specific as she describes an office in "Working Girl":

> In the winter, when the light disappears early, the office has a very strange aura. The ficus trees cast shadows on the desks. The water in the water cooler looks golden—more like wine than water.

You need to be a writer gifted at transubstantiation to get past a lack of originality inherent in your raw materials. The late David Foster Wallace accomplished this rare feat with a tax examiner's stream of consciousness in "Wiggle Room," an excerpt from his posthumous novel *The Pale King* (Little, Brown, 2011), published in *The New Yorker:*

> He did another return; again the math squared and there were no itemizations on 32 and the printout's numbers for W-2 and 1099 and Forms 2440 and 2441 appeared to square, and he filled out his codes... and signed his name and I.D. number that some part of him still refused to quite get memorized so he had to unclip his badge and check it each time and then...put the file in the top tier's rightmost tray...and then unbidden came the thought that *"boring"* also meant something that drilled in and made a hole.

Strategists will recognize in our work lives a "blue ocean opportunity" for writers of serious fiction: "an unknown market space, untainted by competition." If writers won't listen to such corporate-speak, they should pay attention to Ford, who writes in the anthology's introduction, "Work, however we do it or define it, is near the heart of human things; and as with all we know of the heart, its truth is most tellingly found in the acts of our imagination."

Katherine Bell is the deputy editor of Harvard Business Review Group.

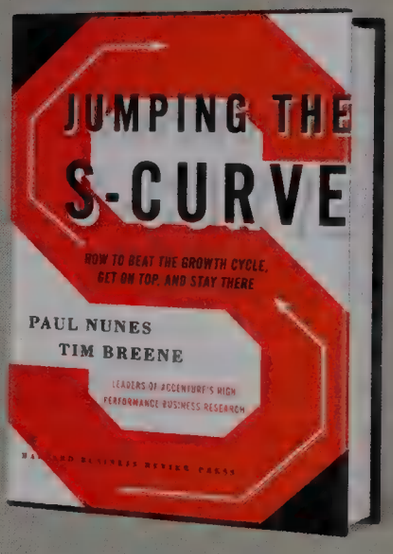
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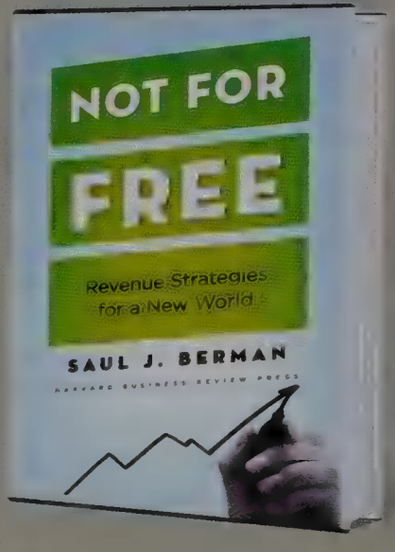
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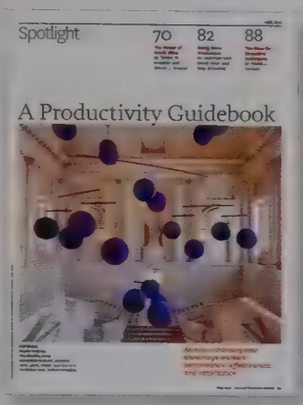
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Executive Summaries May 2011

SPOTLIGHT ON PRODUCTIVITY



This collection of articles includes three perspectives on helping employees do their best, most productive work. First, create conditions that allow them to make progress every day. Second, help them manage their time, energy—and in-box. And finally, push work down to the lowest-cost employee who can do it well.

ORGANIZATION & CULTURE

The Power of Small Wins

Teresa M. Amabile and Steven J. Kramer | page 70

What is the best way to motivate employees to do creative work? Help them take a step forward every day. In an analysis of knowledge workers' diaries, the authors found that nothing contributed more to a positive inner work life (the mix of emotions, motivations, and perceptions that is critical to performance) than making progress in meaningful work. If a person is motivated and happy at the end of the workday, it's a good bet that he or she achieved something, however small. If the person drags out of the office disengaged and joyless, a setback is likely to blame.

This *progress principle* suggests that managers have more influence than they may realize over employees' well-being, motivation, and creative output. The key is to learn which actions support progress—such as setting clear goals, providing sufficient time and resources, and offering recognition—and which have the opposite effect.

Even small wins can boost inner work life tremendously. On the flip side, small losses or setbacks can have an extremely negative effect. And the work doesn't need to involve curing cancer in order to be meaningful. It simply must matter to the person doing it.

The actions that set in motion the positive feedback loop between progress and inner work life may sound like Management 101, but it takes discipline to establish new habits. The authors provide a checklist that managers can use on a daily basis to monitor their progress-enhancing behaviors.

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SELF-MANAGEMENT

Being More Productive

An interview with David Allen and Tony Schwartz | page 82

Allen, the author of the best seller *Getting Things Done*, and Schwartz, the author of the best seller *Be Excellent at Anything* and the CEO of The Energy Project, are two of the world's foremost authorities on increasing personal efficiency. Yet although they agree on much, their ideas on how to maximize the output of knowledge workers are fundamentally different. In this edited conversation with HBR, they discuss their own approaches and what they've learned from each other's work, along with subjects ranging from the distractive pull of e-mail to the benefits of napping in the middle of the workday.

Allen has developed a system of time management that encourages workers to regularly make to-do lists—and helps them blast through the items on them. Breaking down big tasks into smaller "next actions" can help people stay focused and productive, he argues, and multitasking is to be avoided at all costs: We have only so many resources and can do only one thing well at a time.

Schwartz focuses on workers' attitudes and how organizations can help them achieve a mental state that keeps their energy high. People should work for 90 minutes and then take a break to recover, he says. They should tackle their most important task first thing in the morning. And managers should consider themselves "chief energy officers," inspiring and regularly recharging the people they lead—while remembering to meet their own needs as well.

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MANAGING PEOPLE

The Case for Executive Assistants

Melba J. Duncan | page 88

As technology has transformed the workplace and organizations have downsized, companies have sharply reduced the ranks of administrative assistants. But many firms have gone too far.

In their zeal for cutting administrative expenses, numerous organizations now count on highly paid middle and upper managers to arrange their own travel, file expense reports, and schedule meetings. Some companies may see a type of egalitarianism in this assistantless structure—believing that when workers see the boss loading paper into the copy machine, it creates a "we're all in this together" spirit.

But as a management practice, that approach rarely makes economic sense. Generally speaking, work should be delegated to the lowest-cost employee who can do it well. Yet while companies seem to have embraced that logic by outsourcing work to vendors or to operations abroad, they ignore it back at headquarters.

In this article, Duncan, a longtime recruiter of C-suite executive assistants, argues that a good assistant is a crucial productivity booster for a busy executive—one that offers a solid ROI if he or she is deployed correctly.

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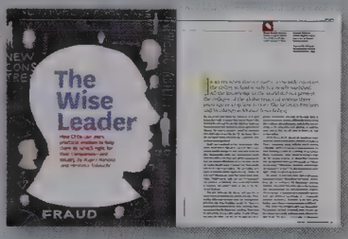
Features

THE BIG IDEA

LEADERSHIP

The Wise Leader

Ikujiro Nonaka and Hirotaka Takeuchi | page 58



Leaders must grasp universal truths from the particulars and the details.

In an era of increasing discontinuity, wise leadership has nearly vanished. Many leaders find it difficult to reinvent their corporations rapidly enough to cope with new technologies, demographic shifts, and consumption trends. They can't develop truly global organizations that operate effortlessly across borders. And they find it tough to ensure that their people adhere to values and ethics. The authors assert that leaders must acquire practical wisdom, or what Aristotle called *phronesis:* experiential knowledge that enables people to make ethically sound judgments.

Wise leaders demonstrate six abilities: (1) They make decisions on the basis of what is good for the organization and for society. (2) They quickly grasp the essence of a situation and fathom the nature and meaning of people, things, and events. (3) They provide contexts in which executives and employees can interact to create new meaning. (4) They employ metaphors and stories to convert their experience into tacit knowledge that others can use. (5) They exert political power to bring people together and spur them to act. (6) They use apprenticeship and mentoring to cultivate practical wisdom in others.

HBR Reprint R1105B

STRATEGY & COMPETITION

The Cosmopolitan Corporation

Pankaj Ghemawat | page 92



Never mind what you've heard about the world being flat. Today's global landscape is marked by unbalanced growth, protectionism, and ethnic, religious, and linguistic divides. Differences still do matter.

The ideal of a truly global, stateless corporation has become popular, but it simply isn't possible to achieve, says the author. Look at Rupert Murdoch's News Corporation. A major player from Australia to the United Kingdom to the United Sates, the company made huge blunders in its move into TV services in Asia, ignoring English-speaking residents' preference for local-language content and touting satellite TV as a threat to totalitarian regimes everywhere (prompting a ban on satellite dishes by the Chinese government). News Corporation had transcended its Australian origins but not its roots in English-speaking democracies.

Crafting a global strategy and organization is possible, but you must focus on understanding the differences among people, cultures, and places—not on eliminating them. One tool that can help you get a handle on the most critical differences is a *rooted map,* which sizes countries according to measures that reflect a particular nation's perspective, such as the amount of industry services they purchase from domestic companies.

A cosmopolitan approach may lead firms, at least in the midterm, to concentrate more on adaptation to local markets than on aggregation or arbitrage. It has various other implications as well. Firms will have to think about how to readjust their organizations to better manage external distances, and they must cultivate leaders who know how to bridge cultural and national differences.

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STRATEGY & COMPETITION

How to Build Risk into Your Business Model

Karan Girotra and Serguei Netessine | page 100



To create value, companies typically focus on revenue, cost structure, and resource velocity. Improving those factors is the main focus of management literature. But all of them are vulnerable to sharp changes in demand and supply.

Companies can innovate their business models to reduce the impact of such swings. But they can also create value by adding some risk. For instance, more than 30 years ago Rolls-Royce identified a major pain point in the aircraft industry: maintenance of airplane engines. An engine breakdown grounds the plane while the airline pays for repair time and materials. So Rolls-Royce offered a service contract whereby the airline would pay for an engine's flight hours rather than for time and materials. The new contract triggered a completely new value creation dynamic, because Rolls-Royce was motivated to improve its own products and maintenance processes.

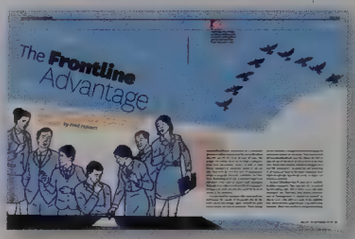
Business model innovations are much cheaper than product and technology innovations, and they can be approached in a systematic way. Furthermore, nearly all the big ones have already been done—so you can simply adapt them to suit your own situation.

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LEADERSHIP

The Frontline Advantage

Fred Hassan | page 106



The managers most responsible for a company's success or failure happen to be the ones with whom the CEO spends the least amount of time: frontline managers, such as shop-floor supervisors, heads of R&D or sales teams, and managers in restaurant chains or call centers. That's a mistake, says Hassan, the CEO who led dramatic turnarounds at Schering-Plough and Pharmacia and who is now a senior adviser at Warburg Pincus.

In this article, Hassan makes the case that systematic interactions with individual and small groups of frontline managers are important to executing a company's strategy and represent an all-important feedback loop that allows the CEO to stay abreast of the latest developments in the business.

He provides guidelines for how CEOs and other senior managers should structure interactions with this vital, and often overlooked, cadre of managers.

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How I Did It

LEADERSHIP

The CEO of Duke Energy on Learning to Work with Green Activists

James E. Rogers | page 51



Rogers was a freshly minted CEO trying to lead Public Service Indiana back from the brink of bankruptcy when the results of a 10-year federal study on acid rain were released. He became convinced that legislation to curb sulfur dioxide emissions was inevitable—and that his industry should have a seat at the negotiating table. Though his peers were opposed to any government action, cap and trade looked to him like a smart and creative compromise that would enable utilities to modernize their plants and meet aggressive emissions targets without sending electricity prices skyrocketing.

In 1990 Rogers testified before Congress in support of cap and trade, which was established by the Clean Air Act Amendments that year. A relatively high number of allowances gave PSI time to make a deliberate and sustainable transition to cleaner generation. Within three years the company's market capitalization had increased by more than 65%, while its price to customers had dropped. By 1995 its sulfur dioxide emissions were down by 30%.

PSI acquired a national reputation; it merged with Cincinnati Gas & Electric to create Cinergy, which in 2006 merged with Duke Energy. Together with 21 other companies and five leading environmental organizations, Duke created the U.S. Climate Action Partnership to lobby for strong federal legislation to reduce greenhouse gas emissions.

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Managing Yourself

Extreme Productivity

Robert C. Pozen | page 127



A veteran top executive at two giant mutual fund companies, the author has also been an attorney, a government official, a law school professor, and a business school professor—sometimes simultaneously. Over the years, he has devised a number of principles and practices to maximize his personal productivity without sacrificing his health or family life. In this article he presents six of them.

Know your comparative advantage. Focus not on what you do best but on what your organization most needs from you—and don't spend too much time on operational details.

It's not the time you spend but the results you produce. Most executives put a huge amount of time into their jobs, assuming that more hours equal more value added. That's too simplistic.

Think first, read or write second. Figure out your argument in advance; then jot down your four or five key points and write the concluding paragraph.

Prepare your plan, but be ready to change it. Arrive early for a speaking engagement in order to grasp the mood of your audience and tailor your speech accordingly.

Let others own their space. Instead of assigning detailed tasks, present general priorities and let your reports decide how to implement them.

Keep things short and simple. Routine meals, naps, and travel habits can save time, effort, and health.

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THE GLOBE

INTERNATIONAL BUSINESS

Cracking the Next Growth Market: Africa

Mutsa Chironga, Acha Leke, Susan Lund, and Arend van Wamelen | page 117



In the 2000s, the African economy finally began to stir. Africa is today the world's third-fastest growing region, and its collective GDP is equal to Brazil's and Russia's. Africans spend nearly $900 billion on goods and services—far more than Indians do. Pent-up consumer demand on the continent is enormous, and so are the opportunities: Consider that telecom companies have added 316 million subscribers—more than the U.S. population—in Africa since 2000.

Yet because of political instability and poverty, many companies have reservations about Africa. To help managers assess whether growth will continue there—and if so, where—McKinsey conducted an economic analysis of the continent and studied its consumer markets. The conclusion: Companies can no longer ignore Africa. But they need to manage risks, develop innovative strategies to deal with gaps in infrastructure and training, and recognize that it isn't one market. There are four main types of economies: diversified, oil exporting, transition, and pretransition. Each presents a different set of opportunities and challenges, and executives must develop their strategies accordingly.

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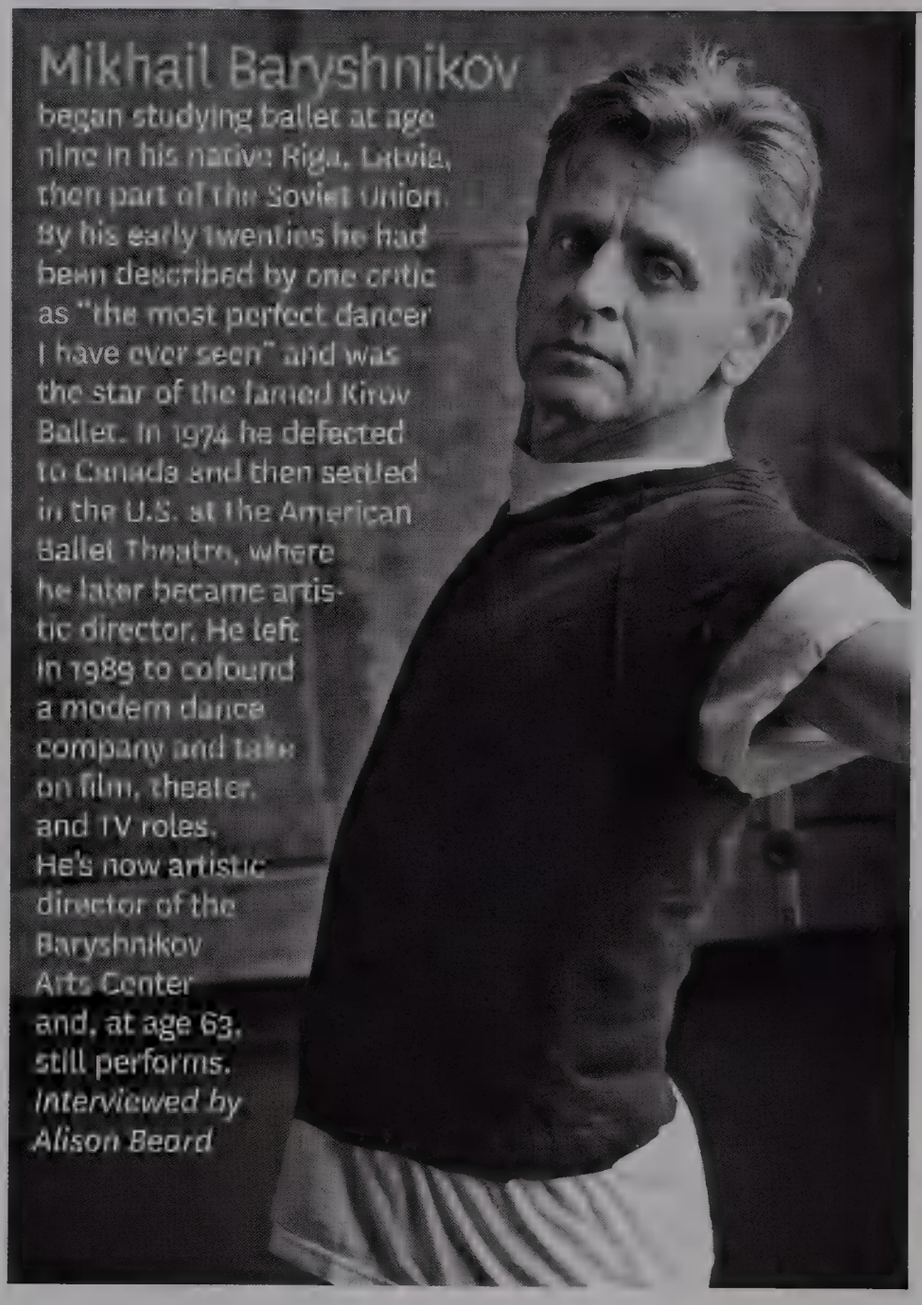
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Life's Work

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Mikhail Baryshnikov began studying ballet at age nine in his native Riga, Latvia, then part of the Soviet Union. By his early twenties he had been described by one critic as "the most perfect dancer I have ever seen" and was the star of the famed Kirov Ballet. In 1974 he defected to Canada and then settled in the U.S. at the American Ballet Theatre, where he later became artistic director. He left in 1989 to cofound a modern dance company and take on film, theater, and TV roles. He's now artistic director of the Baryshnikov Arts Center and, at age 63, still performs. *Interviewed by Alison Beard*

HBR: Your career has been all about reinvention—classical to modern dance, stage to film to TV, performing to managing and back again. Why?
Baryshnikov: It's instinctive. There's an internal clock that dictates what interests me at any given time. Change in any person's life is propelled by an almost primal need to explore, to test boundaries. I just follow that urge. In some cases I look at what others are doing and stubbornly go in the opposite direction. Sometimes it works, and sometimes I fail.

How hard was the transition to management?
I've had the good fortune to work with very structured dance companies, and I could see early on what a huge responsibility managing one would be. When I took it on, it was a growing-up experience. It forced me to make artistic decisions unrelated to my own career and to think more seriously about creating opportunities for others. I think what I've been best at is sticking to a vision—making the tough decisions that might not favor the people I like but that make sense for the organization. When I'm working with other artists I can be an obedient puppy, but in an office situation I like to think I'm the big dog. I don't want to take direction. I haven't always been as patient as I should have been, expecting too much, too fast, and getting frustrated with how long it can take to build support for new ideas. But I'm still learning.

What can you tell us about effective mentoring?
I don't consider myself a mentor; I'm more of a cheerleader. But the best lesson from all the people I've worked with is to understand who you are. Whatever new craft you learn has to go through your own body and mind in order to come out as something revealing and interesting for the audience.

How about effective teamwork?
To really collaborate, you have to figure out how to work with anyone and give 100%. It's about spitting out your ego and becoming a foot soldier when necessary. The creative process isn't a human rights march. Creators can be temperamental. If you can't deal with that, you should step out.

What's the key to mastering new roles quickly?
There is no one secret. It takes positive energy, talent, a lot of hard work, and a willingness to absorb everything possible from the people you're working with. And some luck surely helps. I don't think I always mastered everything. Sometimes I took on too much. But it was a young person's appetite.

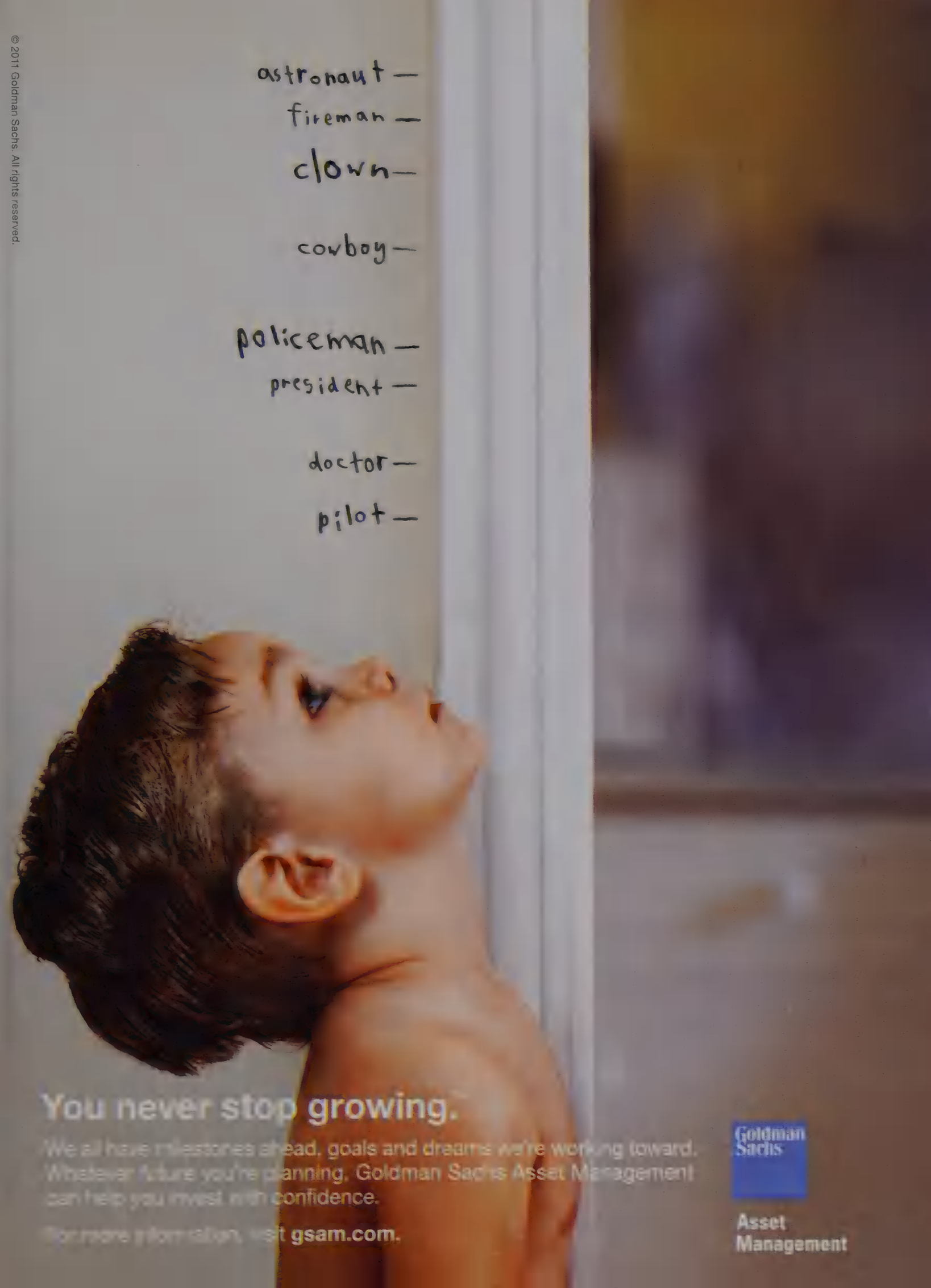
Have you gotten better with age?
I've certainly learned how to pace myself. Age forces you to pare things down to what's essential.

Why is the BAC a cross-disciplinary organization?
The more you see, the more you know, and—hopefully—the better you get. There's this idea that artists shouldn't "pollute" their creative instincts by seeing other artists' work. I think this is wrong.

Why are you so good at what you do?
This is the worst thing one can do: sit around and think about how good you've gotten at something. Besides, I'm not always so great—ask my wife.

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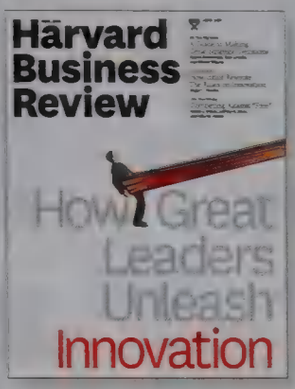
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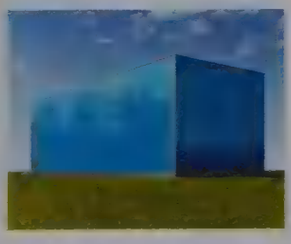
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About the Spotlight Artist
Josef Schulz graduated from the Düsseldorf Academy of Art in Germany with a master's in photography in 2002. He digitally alters his pictures of warehouses, factories, and other non-descript buildings to erase indications of age, location, and environment. Shape and color then become the focus of the images; the buildings resemble toy architecture, appearing to be benign counterparts of themselves.



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Josef Schulz
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2009, C-print,
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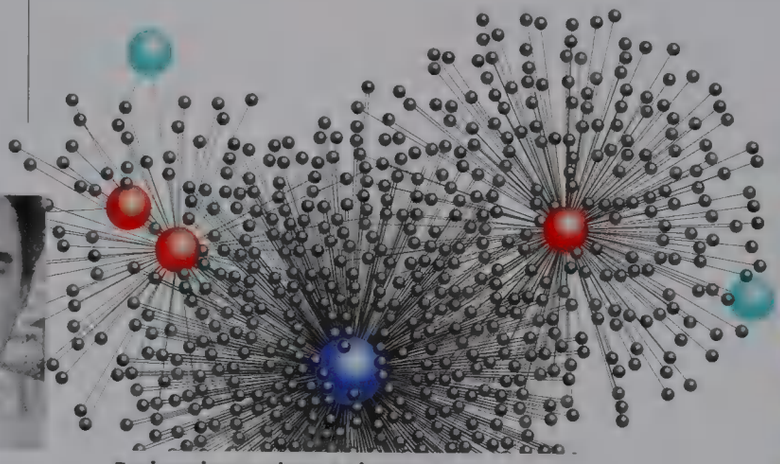
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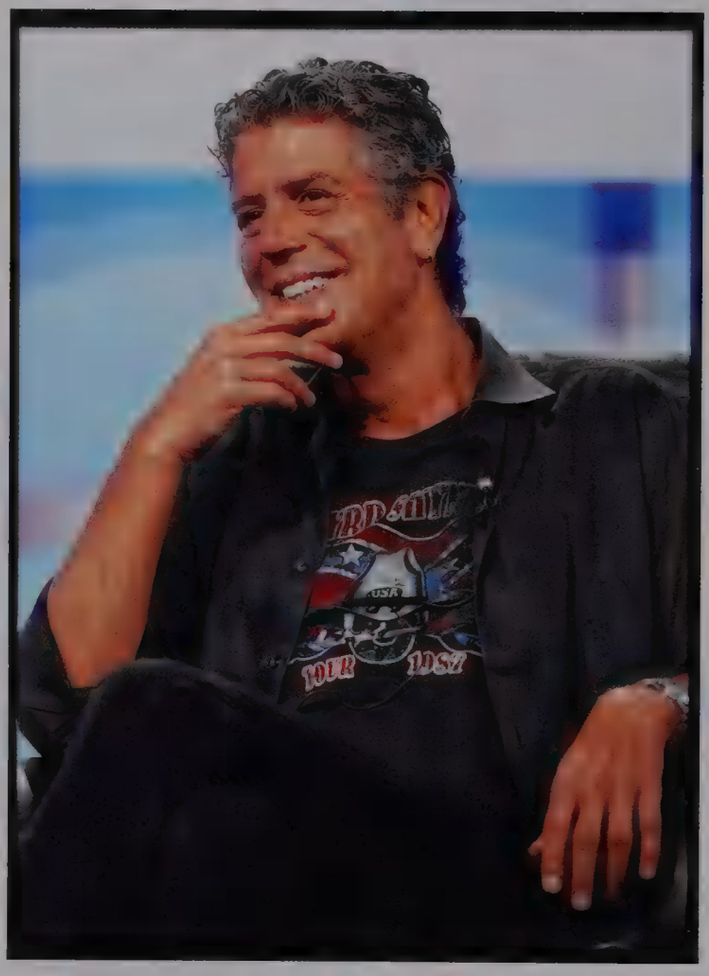
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From the Editor

HBR Everywhere

Holy moly!" was the provocative subject line of an e-mail that Eric Hellweg, the editor of our website, recently sent to all of us here at HBR. The source of his excitement? Monthly unique visitors to the site had passed the 2 million mark for the first time in our history. We had also set our record for monthly page views, with nearly 8 million. These numbers represent dramatic growth for the site: A year ago we had only 1 million monthly uniques. And we've built a community that engages deeply and enthusiastically with our content, posting more than 4,000 comments a month. It's a tribute to the amazing work of our web team, led by Eric and HBR Group deputy editor Katherine Bell.

It took us a while to find our voice online. For decades HBR focused almost exclusively on lengthy pieces based on pioneering academic research—content that wasn't well suited to the web. But in recent years our blogs, audio, video, and other online offerings have become solid complements to HBR's core material. Some of our authors were initially reluctant to join us online, but most now realize that our vibrant online community can help shape and extend their ideas. HBR has become a conversation rather than a lecture, and a lively one at that.

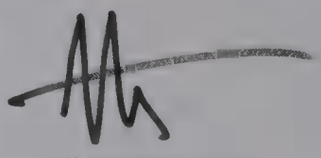
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The web is ideal for delivering timely content to our readers, who consistently say they want more help implementing the ideas in HBR. Our Best Practices blog posts and our popular Management Tip of the Day app and e-mail newsletter offer practical guidance; we'll be introducing other tools in the months ahead.

The print magazine remains our flagship. It's still the best format for long-form ideas that drive debates on leadership, the future of the global economy, and other big topics. As a lifelong print editor, I have deep affection and appreciation for what a magazine can do. But I've come to realize that being able to share ideas faster and refine them with the help of an online community has raised our game—in print, too. I invite you to join the conversation at hbr.org.



Adi Ignatius, Editor in Chief


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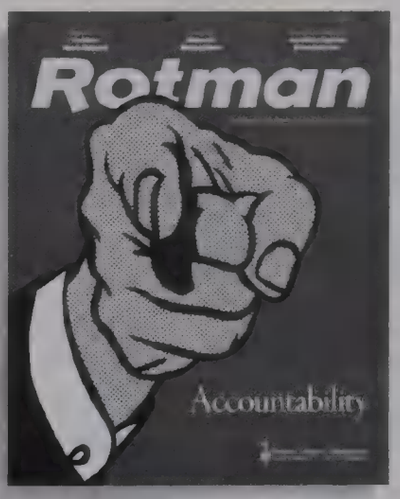
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Blockbuster's Former CEO on Sparring with an Activist Shareholder

HBR article by **John Antioco,** April 2011

The dramatic story of Blockbuster's near demise may have "turned out differently," say both its former CEO and the activist shareholder who ousted him. During a decade at the helm, Antioco faced market shifts with the conviction that Blockbuster's brand would hold up. He attributes its failure to Carl Icahn, who won three board seats in a proxy fight and ultimately forced Antioco to resign, arguing that Antioco's pay was excessive. In the end, Icahn concedes two points: Blockbuster was "the worst investment I ever made," and Antioco might have been more capable than his successor.



Whenever Carl Icahn appears on the scene, he reminds me of Gordon Gekko in the movie *Wall Street*. Icahn strips, shreds, dumps, and otherwise decimates a business's ongoing concerns—and then manages to walk away with a ton of money. That is not capitalism. Instead of building, corporate raiders destroy—and I find it especially galling when they say "I really liked these people" as they ride off to contemplate their next target.

Nick Harrington, former assistant to international marketing director, Boise Cascade

A $50 million golden parachute? What was the board thinking? Directors who agree to an exit package like that while the company was barely breaking even for over a decade are clearly unfit for their duty to shareholders. Shame on the board.

Kyle G. Schrieffer, CFA Candidate

Blockbuster was fighting an uphill battle against customers annoyed by late fees (including me) and against Netflix—it lost first-mover advantage. Blockbuster's online service was a failure before it began: Like many corporate giants, Blockbuster suffered from a case of hubris.

Cameron Clark, Environmental Health & Safety Director, EchoStar Broadcasting

I applaud HBR for publishing stories like this that review business decisions and provide a chance for the parties involved to share their recollections of how decisions and choices were made. There is far too little introspection of this type among executives today.

Steve Findley, managing director, Media Investment Management

Icahn never did anything for shareholders. He always had only himself in mind. The fact that he was also a shareholder in instances where he took action was always

How to Avoid Catastrophe

HBR article by **Catherine H. Tinsley, Robin L. Dillon,** and **Peter M. Madsen,** April 2011

Small failures permeate day-to-day business but cause no immediate harm—and often go unnoticed. Managers ignore these near misses due to cognitive biases that build up over time.

Numerous studies have highlighted that when people behave unethically or carelessly, those who were supposed to monitor them do not notice the changes when they are small ones. This was the case with the auditors at Enron, where asset values were inflated or hidden off the books, and at WorldCom, where earnings were grossly inflated. And this was the case again with BP and the oil rig disaster in the Gulf of Mexico. Unethical policies contributed, but a significant portion of these disasters was the result of unintentional misconduct. More study could perhaps determine how small and how slow the erosion in others' ethicality has to be in order to remain unnoticed.

Herve Pourcines, partner, Nova Trust Advisors

According to research, we humans don't tend to react to risks unless they cause

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incidental. His time horizon was rarely if ever long-term.

Walter Pressey, former president and vice chairman, Boston Private Financial Holdings

I've worked for Blockbuster for five years. What we need now is a leader who can take this company out of the ruins. We need a Lee Iacocca type who can get us back on track. We don't need all this public finger-pointing, blaming the bankruptcy on this or that.

Anonymous Blockbuster Employee

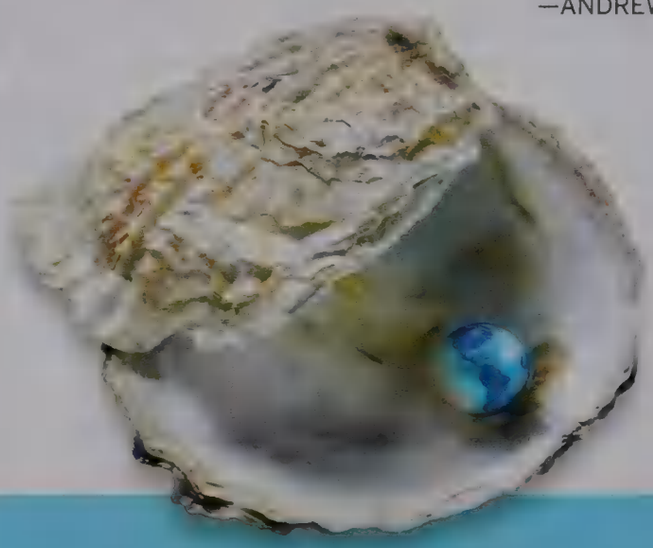
Antioco responds to Icahn's article, "Why Blockbuster Failed": *It's always struck me as strange that it's okay for Carl to make billions on his version of truth and justice, but CEOs making a lot of money—usually on stock appreciation—are "egregious" (one of Carl's favorite words)....I hope someday Carl invites me back to have dinner at Il Tinello so we can reminisce over a few martinis and some Pasta alla Icahn. It might be fun, since I largely agree with his assessment that "things might have turned out differently" for Blockbuster if we had avoided the blowup over my compensation package that led me to leave.*

us to personally suffer. Seeing others suffer isn't enough to jolt us into action, and neither are near misses. Last year our company did research into business-continuity management and found that fewer than half of companies have any plan in place to hedge against risks. It takes more than a near miss to change behavior.

Adrian Gaskell, web manager, Chartered Management Institute

"The first one gets the oyster, the second one gets the shell."

—ANDREW CARNEGIE



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1.

Why Most Product Launches Fail

HBR article by **Joan Schneider** and **Julie Hall,** April 2011

Despite huge investments in market research and R&D, "about 75% of consumer packaged goods and retail products fail to earn even $7.5 million during their first year." To avoid new-product failures, Schneider and Hall suggest doing careful testing, delaying launch until the product is really ready, ensuring customers understand how to use the product, and making sure the manufacturing and distribution systems can handle rapid growth if the product really takes off.

In technology firms, rapid product development causes organizational gears to spin wildly out of control and, in many cases, collapse in on themselves. Developers may be happy letting new products "appear" or "leak out" when they're ready, but this practice drives managers and marketers to distraction. A market window needs to be clearly established. Better firms at least have a notion of when to enter the scene.

Steven Haines, president, Sequent Learning Networks

Communication is the recurring soft spot. By the time every empire defends its turf, the product's reason for being has been overshadowed—and one of the biggest hurdles is prioritizing customer needs over individual employees' career goals.

George Mann, partner, Waverley Rental Properties

The authors respond: *A launch champion must not only own the launch but also bring the various disciplines together. A CLO—chief launch officer—would put new-product launch where it belongs, in the C-suite.*

How does this advice apply to the online world, where the conventional wisdom is to launch early and iterate often?

Karim Sarkis, executive director, broadcast group, Abu Dhabi Media

The authors respond: *We are watching a lot of app launches closely, and there are still some tried-and-true launch tenets, such as motivating your base while developing your product and using it to "grease the skids" for your launch.*

Small companies will not know the answers to some of these questions until launch—these firms are especially reliant on feedback from early adopters. If you are small, launch sooner rather than later and listen closely to your customers.

Chris Hawkins, CEO, SignNow

The authors respond: *Our article illustrates two examples of small businesses that underestimated manufacturing capacity or consistency and launched too soon or too quickly. Launching with confidence—one of the measures of success we're looking at—is size agnostic.*

The missing ingredient in failed launches is integrating basic marketing principles like positioning, branding, and messaging into an iterative research process. Too often, in the research phase, the focus is solely on a product's features and functionality.

Phil Corse, lecturer of marketing, Kellogg School of Management

Research needn't be expensive. Take a booth at the local shopping mall and talk to consumers. Repeat this process several times in different locations. Of course, listening to the results and acting on them, well, that's a different animal.

Wayne Spivak, president, SBA Consulting

2.

Why Leaders Don't Learn from Success

HBR article by **Francesca Gino** and **Gary P. Pisano,** April 2011

Failed products and systems may warrant systematic analysis of what went wrong, but few think successes deserve postmortems. HBS professors Gino and Pisano challenge the status quo, contending that success breeds failure on a cognitive level by hindering the learning process for both individuals and organizations.

How do we capture what went wrong in a truthful way while showcasing what went right? People don't want to reveal their shortcomings. Is there a masterful way to do this so others can really learn?

Jamie Muskopf, fleet knowledge management officer, United States Pacific Fleet

An experimental approach that investigates good performance and nurtures an environment that allows this to take place may require a major shift. Often there isn't even enough time to learn from failures.

Christine Maingard

Lessons learned from successes and failures are in fact being used to shape the organization; however, a central repository of collected lessons may not exist. Whose role is it to observe performance? I wonder if companies have the staff to ensure that this activity is constantly being monitored.

Sheldon E. Muir, Six Sigma black belt, Enterprise Networks, TE Connectivity

In the words of Bill Gates: "Success is a lousy teacher. It seduces smart people into thinking they can't lose."

Ronald S. Woan, former vice president of research, Azaleos

The Ambiguous "Gift" Of Innovation Failure

Blog post by **Michael Schrage,** March 2011, in response to "I Think of My Failures as a Gift," an interview with A.G. Lafley

The former P&G CEO recalls learning from the company's failed attempt to test-market its Vibrant color-safe bleach in Portland, Maine—where Clorox responded by giving free bleach to every household in the city. Lafley says, "When Clorox tried to enter the laundry detergent business a few years later, we sent them a similarly clear and direct message—and they ultimately withdrew their entry."

Schrage responds in his blog post: *"Does that mean that innovation...is less about offering the best value to customers than preventing your competition from offering the best valuable to customers?...Was what Clorox did to P&G ethical?"*

Clorox used its leading market position and went all out to protect itself by saturating the market. Clorox may have acted with too much zeal and potentially broken some fair-market laws, but it had a definite strategy and it was well executed.
Sartaj Anand, junior fellow, The Melton Foundation BMS

Clorox acted in what it considered to be its self-interest, divulging a deep structural weakness—an utter lack of confidence in its product and itself. In this way, its countermeasure to P&G's test was unsustainable—and a near-hysterical panic-button response.
Michael Moon, CEO, Gistics

Correction: *In "Building Resilience," by Martin E. P. Seligman (HBR April 2011), a reference to Victory University in Memphis, Tennessee, should have read "Fort Jackson's Victory University in Columbia, South Carolina." We regret the error.*

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Women raise a group's intelligence

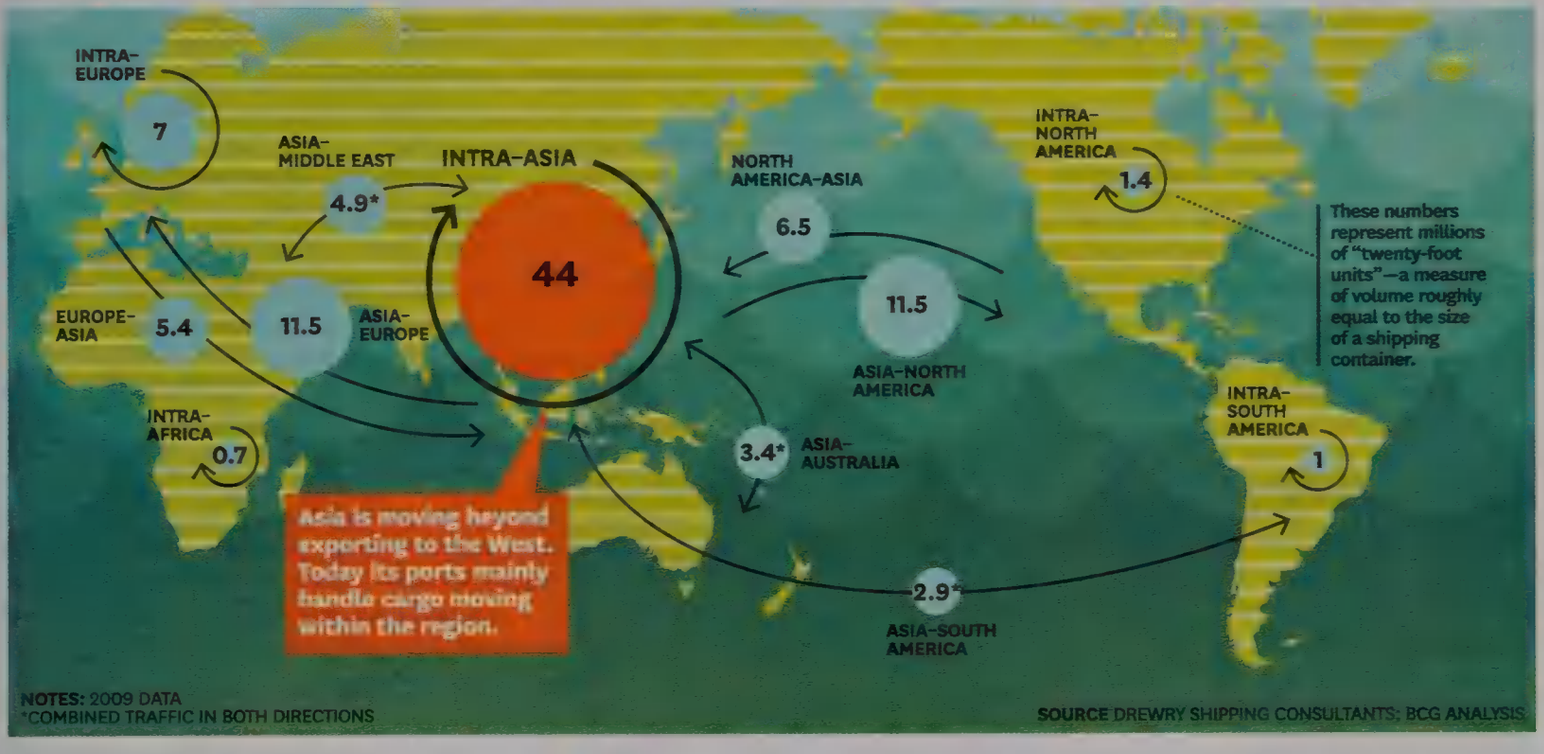
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FIRST

What the West Doesn't Get About China



Its export-focused economy is giving way to a consumer-driven market more quickly than most companies think. Here's how to adapt.

by George Stalk and David Michael

When many managers think about China, they imagine a container ship whose hold and deck are brimming with cartons of toys, clothing, iPhones, and other goods bound for the world's consumer markets, whose populations power China's economic engine.

That view couldn't be more wrong.

Despite the Chinese government's well-publicized program to encourage domestic consumption, few Westerners grasp just how much progress the country is making on this front. Although millions of peasants live on subsistence wages, millions more Chinese are moving to urban centers and achieving a recognizably middle-class lifestyle. Consider just a few data points that give evidence of China's unexpectedly fast-paced move toward a more balanced, consumer-driven economy:

- In a variety of consumer categories—including such items as shoes, consumer electronics, and jewelry—China already ranks as the number one or number two market in the world. (See the list on the following page.)
- The combined flow of shipping containers between Asia and North America and Asia and Europe is already less than

the flow among Asian nations—with much of the latter consisting of goods imported to China.

- Domestic demand accounts for most sales of Chinese-produced air conditioners, motorcycles, trucks, and steel.
- Adoption rates of new technologies among the rising middle class exceed those of nearly every other developing country. China has 400 million internet users, most with broadband access. Mobile telephony is ubiquitous in urban areas, and most of its consumers have leapfrogged landlines.
- China's cities are growing so quickly that the country now has more urban centers than most Western nations do. For instance, China has about 90 cities with a middle-class population of 250,000 or more; the U.S. and Canada together have fewer than 70. According to projections, by 2020 China will have 400 cities with at least 250,000 middle-class inhabitants—and 50 of those cities will have more than 1 million middle-class inhabitants. And by then it is expected to have 800 cities whose residents' real disposable incomes are greater, on average, than those of Shanghai's residents today.
- Looking beyond consumer markets, we find that Chinese companies are already recognized as among the world leaders in numerous B2B technologies, including wind-turbine blades, solar panels, high-speed rail equipment, steam boilers, port terminal cranes, and electric-transmission equipment.

Few Western managers who visit China get a realistic picture of its economic development. They typically go to Beijing or Shanghai. They stay in five-star hotels—often Hiltons and Hyatts. There's apt to be a Starbucks in the lobby. The familiar atmosphere leads them to think that China's market will someday resemble a typical Western economy, full of Western-made products. But in fact, cities far from Beijing and Shanghai are teeming with goods and services from domestic companies—and if Western companies don't get to those cities soon, they'll be left out.

To be sure, despite its rapid progress China is still far from self-sufficient in a number of areas. It remains dependent on foreign multinationals for market access—many Chinese companies lack the ability to generate significant export trade on their own. The country can provide a college education for a growing share of the population but still relies largely on foreign universities for top-flight graduate education. Its only traditional energy resource is coal, and its demand for imported oil has been a major factor in rising prices over the past decade. China is also a net importer of food. Finally, it lacks the innovative pharmaceutical and health care sectors of Western economies, and as its consumers become increasingly upscale, they will demand more of the pills and procedures that Westerners take for granted.

How MNCs Should Navigate the Emerging China

Although every multinational has a China strategy, most companies aren't moving quickly enough for their strategies to succeed. To better position themselves, they need to be aware of these trends:

First, the rise of domestic competitors will happen faster than most MNCs expect. Local companies in some high-growth markets—for example, Xizi in elevators, 7 Days Inn in budget hotels, and Midea in consumer appliances—have already become leaders. Multinationals that hope to have strong market share a few years down the road need to establish themselves now.

Second, whether or not they are currently selling in China, companies looking to capitalize on the opportunities there need to be ready to do business in hundreds of locations, not just in a handful of the current megacities. This has dramatic implications for organizational structure, distribution infrastructure, choice of business partners, and the amount of capital needed.

Third, companies must prepare for extraordinary growth in demand. Some Western companies today are struggling to handle 35% annual sales growth in China—but the markets they're playing in are growing at 60%. Despite their enormous invest-

AN "EMERGING" MARKET? NOT IN THESE CATEGORIES

China is already the world's largest or second-largest consumer of a variety of products:



HOW FIVE MULTINATIONALS FIGURED CHINA OUT

Volkswagen

The German multinational was the first Western automaker to enter China, establishing its initial joint venture there in the 1980s, when other car manufacturers considered the country too risky. By the 1990s it had captured up to 90% of the market for passenger cars. Though it has since lost share to other overseas companies, it sold 1.9 million vehicles in 2010.

Yum Brands

The parent company of KFC, the first fast-food chain to open in China, Yum is the largest and fastest-growing restaurant chain in the country. It currently operates nearly 3,800 restaurants (more than 500 of which opened in 2010) in 700 cities across China.

Procter & Gamble

The consumer-goods giant has several brands that hold the top spot in the Chinese market, including Rejoice, Safeguard, Olay, Pampers, Tide, and Gillette. Fully 98% of its employees are Chinese, including many in top management positions. P&G recently opened the Beijing Innovation Center, which will provide global R&D support, and plans to invest at least $1 billion in China over the next 5 years.

Nokia

Having initially entered China as a network equipment supplier, Nokia is now the largest mobile-phone manufacturer in China, and China is its largest market.

General Electric

GE has operated in China for many decades in sectors including energy, aviation, health care, and transportation. It plans to extend its Chinese operations even further and recently announced five new deals expected to generate $2 billion in revenue.

SOURCE COMPANY WEBSITES

The rise of local competitors will happen faster than most multinationals expect. MNCs that hope to have strong market share in China in a few years need to establish themselves now.

ments in human and capital resources, these companies are already ceding share to competitors—and their competitors will increasingly be Chinese companies. In a market growing this quickly, it can be worthwhile to build excess capacity, and it's smart to take a hard look at whether your present forecasts may be overly conservative.

Fourth, Western companies need to understand that Chinese consumers have very different needs than consumers in their home markets. Chinese households don't want cappuccino machines; they want water filters, air filters, and soy milk makers (at the moment, one of the hotter consumer categories in China—and one with no foreign competition). The classic example involves automakers, which had to learn that many Chinese who can afford cars like to employ drivers—so backseat features are very important to them.

Fifth, MNCs must realize that product adoption rates will be higher in China than in most markets they've experienced, meaning that in some categories, the competitive landscape will be settled quickly. Companies that don't strive to be number one at the outset won't have the luxury of entering and being competitive later.

Sixth, as Chinese companies gain prowess in their home market, more will expand abroad. They are likely to move into Africa and South America before they enter North America and Europe. Whether they realize it or not, Western companies aren't fighting just for a position in the Chinese market—they're also fighting to forestall potential competitors in other emerging markets and eventually on their own turf. MNCs may not be inclined to pay much attention to small local companies in China today, but they should.

Last, Western companies will increasingly be on their own when dealing with many of the politically based difficulties of doing business in China. The power of Western governments to impose their will on the Chinese is diminishing rapidly—if it was ever really there at all—as the rise of China's own markets makes the country less dependent on Western companies. Competing in China will have less to do with government policy and more to do with offering the right products and services to the right customers at the right price.

Some Western companies are showing adroitness in exploiting the new opportunities in China. Among them are General Motors, General Electric, Honeywell, Phillips, Emerson, and Yum Brands. (See the chart above.) But these are exceptions. Most Western companies underestimate how quickly the Chinese market is developing and how little time they have to establish a competitive foothold—particularly in cities other than Beijing and Shanghai.

In many ways China today is what the United States was to Great Britain in the late 1800s. British managers couldn't imagine or execute the strategies necessary to do business in a geographical landscape far vaster than their home market. The same challenges now face Western managers in China, but on an even greater scale: Never before have businesses had to deal with market opportunities spread across such a wide geography, with so many different languages and ethnic populations. These are challenges that require aggressive action—and ones few companies are currently prepared to meet.

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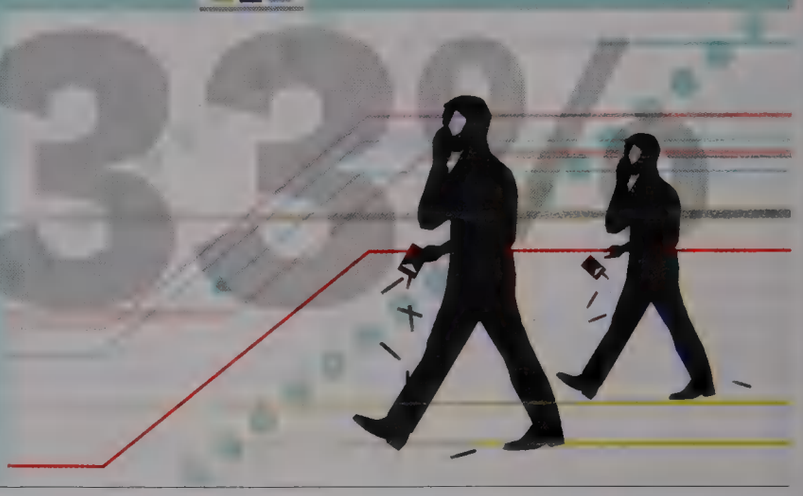
George Stalk is a senior adviser and fellow at Boston Consulting Group. **David Michael** is a senior partner at BCG and heads the firm's globalization practice.

Stat Watch

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Smoke? No Thanks, I'm Too Busy Texting

Tobacco use by Filipinos over the age of 15 dropped by 33% in households that bought a mobile phone, according to a World Bank study conducted by **Julien Labonne** and **Robert S. Chase**. When cash-strapped consumers in developing countries must choose among luxuries, many prefer the phone to the cigarette, the researchers say. Spending on mobile phones does not appear to have any tempering effect on alcohol consumption, however.



FINANCE *by Theo Vermaelen*

An Innovative Approach To Funding CSR Projects

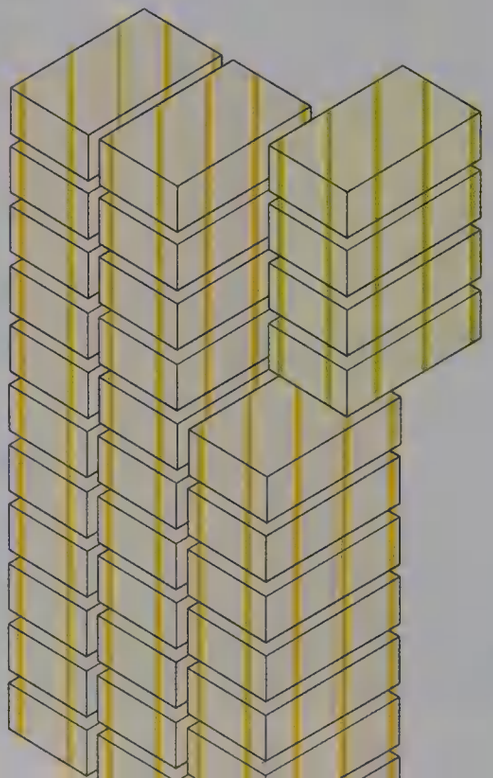
Corporate social responsibility remains a deeply controversial issue in business circles. Critics argue that CEOs who want to support social initiatives should use their own money, not that of shareholders. In their view, CSR is a stealth tax that starves the value-creation process of capital. If we want to redistribute wealth, they say, let's wait until the wealth has been created.

Proponents contend that CSR itself is a wealth-creating opportunity. A company with environmentally friendly practices, they believe, may take in extra revenue from consumers who applaud their position. It may attract idealistic employees who will work especially hard or accept lower pay. Its initiatives may generate subsidies or tax credits. And its capital costs may be lower than average because investors who value its environmental rating will be satisfied with more-modest returns.

However, it's hard to show that companies do generate new revenue or have lower labor costs because of any given CSR practice. There's also no conclusive evidence that capital costs are reduced, although this may be because the long-term data needed for a meaningful analysis are difficult to obtain. Indeed, one reason the debate rages on is that neither side can prove its case.

Rather than engaging in this unwinnable argument, managers should turn to innovative financing techniques and a new class of assets to fund CSR projects. Instead of requiring all shareholders to contribute to CSR investments, they should use capital only from investors who opt in, with the understanding that the objective is not simply to make money but also to do good. The prices of these assets would therefore be set by investors who are fully aware that they might see lower returns.

Consider the controversy at ExxonMobil. In 2008 shareholders belonging to the Rockefeller family—descendants of the founder—began pressing the CEO to move into alternative energy. Their motive, according to the *Wall Street Journal,* was in part "to remove the stain of oil from the Rockefeller name." The CEO successfully opposed the proposal, believing that most shareholders would object.



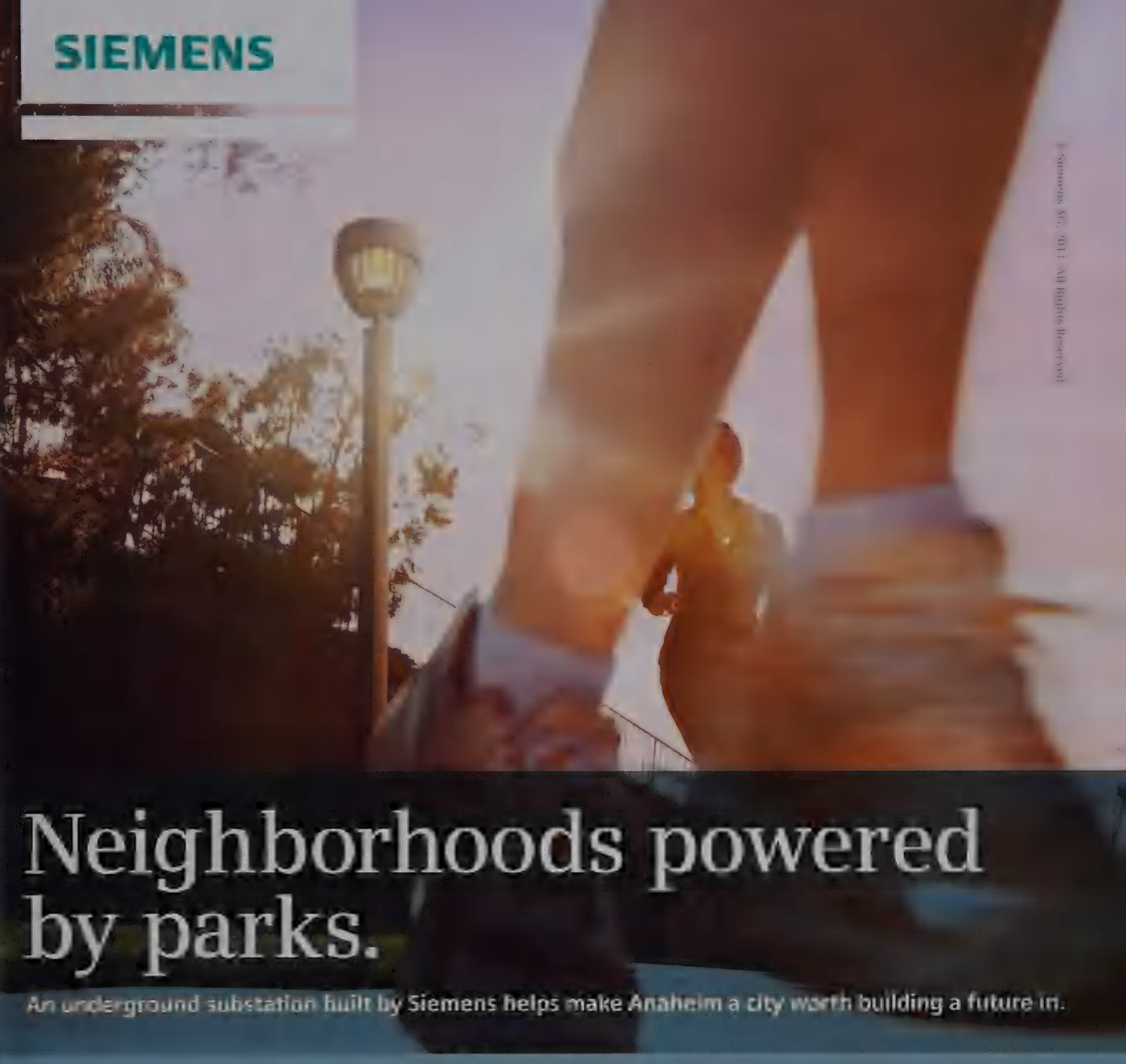
There's a creative solution to this type of conflict: an equity carve-out. Exxon could establish an alternative-energy subsidiary. It would own a controlling stake, but funding would come from new investors—people, such as the Rockefellers, who want to support alternative energy. (The controlling stake would compensate the parent company for the use of its brand name, its expertise, and perhaps some limited investment. Without the benefit of the parent company's involvement, dissenting shareholders in the parent company might simply sell their shares and set up their own firm.) If the subsidiary failed, the losses would be confined to the new investors. If it succeeded, the profits would be enjoyed by them and by Exxon's shareholders at large.

Such an approach suggests a more productive way to frame the CSR issue. Instead of using the term "social responsibility"—which implies that firms without a CSR program are irresponsible—why not talk about "social investment vehicles"? That would signal that the company was giving shareholders a choice, rather than imposing an obligation they couldn't reject without appearing uncaring and greedy.

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Theo Vermaelen is a professor of finance at Insead.

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Research Watch

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Two Shots for Her, Just One for Him

When it comes to collaborating on stressful tasks, caffeine impairs men's performance but boosts women's, according to a study led by **Lindsay St. Claire**, of the University of Bristol. The researchers call for further investigation of men's inclinations to "fight or flee" under stress while women "tend and befriend," and of whether caffeine somehow intensifies those behaviors. And they posit that serving caffeinated drinks at business meetings might "unintentionally sabotage" the collaboration needed to resolve the issues on the agenda, especially in male-dominated environments.



MARKETING *by Philipp Schmitt, Bernd Skiera, and Christophe Van den Bulte*

Why Customer Referrals Can Drive Stunning Profits

For companies wondering whether their referral programs are accomplishing anything other than giving established customers some extra cash, our research provides some reassurance: A customer referral program can in fact be strikingly profitable.

We studied 10,000 accounts in a large German bank over a period of three years, and found that customers obtained through referrals are both more loyal and more valuable than other customers. After controlling for such factors as age and gender, we calculated that referred customers are, on average, about 18% more likely than others to stay with the bank. We also projected that they generate 16% more in profits (amounting to €40 each). Thus, the bank earns a return of about 60% on its €25 referral reward.

The bank's managers were relieved to hear these results. They'd feared that their current customers, in pursuit of easy cash, might be bringing in anyone and everyone they could—and that the ensuing pool of new customers would be full of low-profitability clients.

There are some interesting wrinkles in the program's effects. One is that the profit margins from referred customers are substantially higher only at the beginning; the difference decreases over time and vanishes after about two and a half years. The reason for this, we think, is that customers who make referrals are essentially matchmakers, and good ones: They bring in people who like the bank's products, services, location, hours, and fees. Because these new customers are good matches, they quickly find features they want and are willing to pay for. They require fewer marketing efforts than nonreferred new customers, so they generate more revenue at a lower cost. But this advantage wanes as nonreferred customers learn to navigate the bank and its offerings and as the bank, through personal interactions and analysis of their records, learns what they want and targets its marketing accordingly.

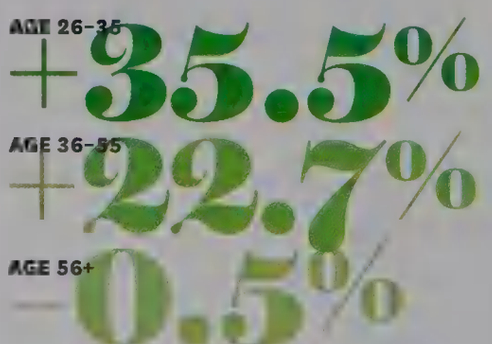
Breaking down our data by age, we found that the most-pronounced difference in overall value between referred and nonreferred customers is among young people. It's about €80 for customers 26 to 35 years old, €58 for those 36 to 55 years old, and slightly negative for those over 55. We believe this is another effect of good matchmaking. Because young customers have short credit histories and financial track records, data-mining techniques are not very effective at identifying the best prospects among them. Referrals appear to generate customers for whom the bank is a good fit regardless of age.

We hypothesize that the referral effect applies to other consumer industries. In particular, we expect that referral programs would be most beneficial for products and services that customers might not appreciate at first glance and in industries where it's hard to identify valuable prospects. We encourage companies to compare the profitability of their referred and nonreferred customers. Here are some questions they should ask: What kinds of customers are most likely to bring in highly lucrative referrals? Once the high-ROI referrers have been identified, how can companies market selectively to them? What referral reward strikes the optimal balance between the acquisition cost and the subsequent value of a customer? Simple experiments can help companies answer these questions and get better at turning their customers' social capital into their own economic capital.

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AGE AND THE REFERRAL EFFECT

Here's the extent to which referred customers are more profitable:



Philipp Schmitt is a graduate of the business and economics doctoral program at Goethe University, in Frankfurt; **Bernd Skiera** is a chaired professor of electronic commerce there. **Christophe Van den Bulte** is an associate professor of marketing at the University of Pennsylvania's Wharton School.



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Defend Your Research

HBR puts some surprising findings to the test

What Makes a Team Smarter? More Women



Anita Woolley (awoolley@cmu.edu) is an assistant professor of organizational behavior and theory at Carnegie Mellon University.



Thomas Malone (malone@mit.edu) is the Patrick J. McGovern Professor of Management at the MIT Sloan School of Management and the founding director of the MIT Center for Collective Intelligence.



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The finding: There's little correlation between a group's collective intelligence and the IQs of its individual members. But if a group includes more women, its collective intelligence rises.

The research: Professors Woolley and Malone, along with Christopher Chabris, Sandy Pentland, and Nada Hashmi, gave subjects aged 18 to 60 standard intelligence tests and assigned them randomly to teams. Each team was asked to complete several tasks—including brainstorming, decision making, and visual puzzles—and to solve one complex problem. Teams were given intelligence scores based on their performance. Though the teams that had members with higher IQs didn't earn much higher scores, those that had more women did.

The challenge: Are brainy people overrated? Are women the true key to success? **Professors Woolley and Malone, defend your research.**

Woolley: We've replicated the findings twice now. Many of the factors you might think would be predictive of group performance were not. Things like group satisfaction, group cohesion, group motivation—none were correlated with collective intelligence. And, of course, individual intelligence wasn't highly correlated, either.

Malone: Before we did the research, we were afraid that collective intelligence would be just the average of all the individual IQs in a group. So we were surprised but intrigued to find that group intelligence had relatively little to do with individual intelligence.

HBR: But gender does play a role?

Malone: It's a preliminary finding—and not a conventional one. The standard argument is that diversity is good and you should have both men and women in a group. But so far, the data show, the more women, the better.

Woolley: We have early evidence that performance may flatten out at the extreme end—that there should be a little gender diversity rather than all women.

You realize you're saying that groups of women are smarter than groups of men.

Woolley: Yes. And you can tell I'm hesitating a little. It's not that I don't trust the data. I do. It's just that part of that finding can be explained by differences in social sensitivity, which we found is also important to group performance. Many studies have shown that women tend to score higher on tests of social sensitivity than men do. So what is really important is to have people who are high in social sensitivity, whether they are men or women.

So you didn't see a negative correlation with individual IQs—just a very weak positive correlation. In theory the 10 smartest people could still make a great group, right?

Woolley: In theory, yes, the 10 smartest people could make the smartest group, but it wouldn't be just because they were the most intelligent individuals. What do you hear about great groups? Not that the members are all really smart but that they listen to each other. They share criticism constructively. They have open minds. They're not autocratic. And in our study we saw pretty clearly that groups that had smart people dominating the conversation were not very intelligent groups.

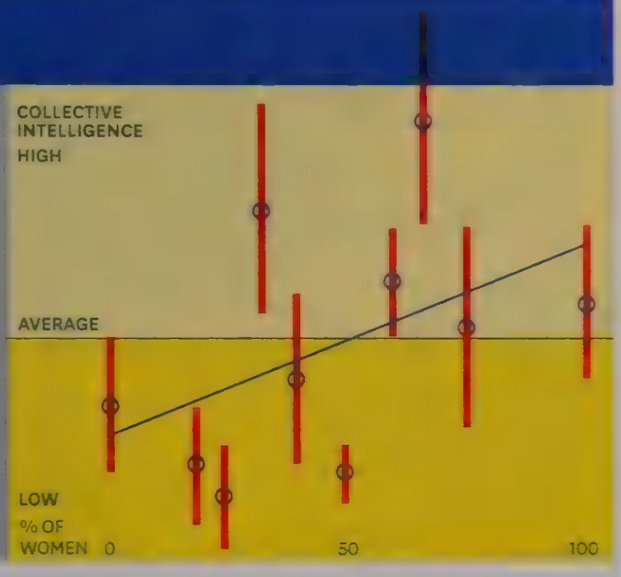
Can teams be too group oriented? Everyone is so socially sensitive that there's no leader?

Woolley: Anecdotally, we know that groups can become too internally focused. Our ongoing research suggests that teams need a moderate level of cognitive diversity for effectiveness. Extremely homogeneous or extremely diverse groups aren't as intelligent.

In some ways, your findings seem blindingly obvious: that teams are more than just a collection of the best talent.

The Female Factor

The chart plots the collective intelligence scores of the 192 teams in the study against the percentage of women those teams contained. The red bars indicate the range of scores in the group of teams at each level, and the blue circles, the average. Teams with more women tended to fall above the average; teams with more men tended to fall below it.



Malone: Sure. This is well-known in sports. Our study shows it with intellectual tasks. We realized that intelligence tests are a way to predict individuals' performance on a range of tasks, but no one had thought of using the same approach to predict group performance.

Woolley: There was a step change in psychology once the field had an empirical method of measuring individual intelligence through IQ tests. We're hopeful that this work can create a similar seismic shift in how we study groups.

Can we design teams to perform better?

Malone: We hope to look at that in the future. Though you can change an individual's intelligence only so much, we think it's completely possible to markedly change a group's intelligence. You could increase it by changing members or incentives for collaboration, for instance.

Woolley: There is some evidence to suggest that collective intelligence exists at the organizational level, too. Some companies that do well at scanning the environment and setting targets also excel at managing internal operations and mentoring employees—and have better financial performance. Consistent performance across disparate areas of functioning suggests an organizational collective intelligence, which could be used to predict company performance.

So this phenomenon could extend beyond the small groups you studied?

Malone: Families, companies, and cities all have collective intelligence. But as face-to-face groups get bigger, they're less able to take advantage of their members. That suggests size could diminish group intelligence. But we suspect that technology may allow a group to get smarter as it goes from 10 people to 50 to 500 or even 5,000. Google's harvesting of knowledge, Wikipedia's high-quality product with almost no centralized control—these are just the beginning. What we're starting to ask is, How can you increase the collective intelligence of companies, or countries, or the whole world?

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Many factors you might think would be predictive of group performance were not. Group intelligence had little to do with individual intelligence.

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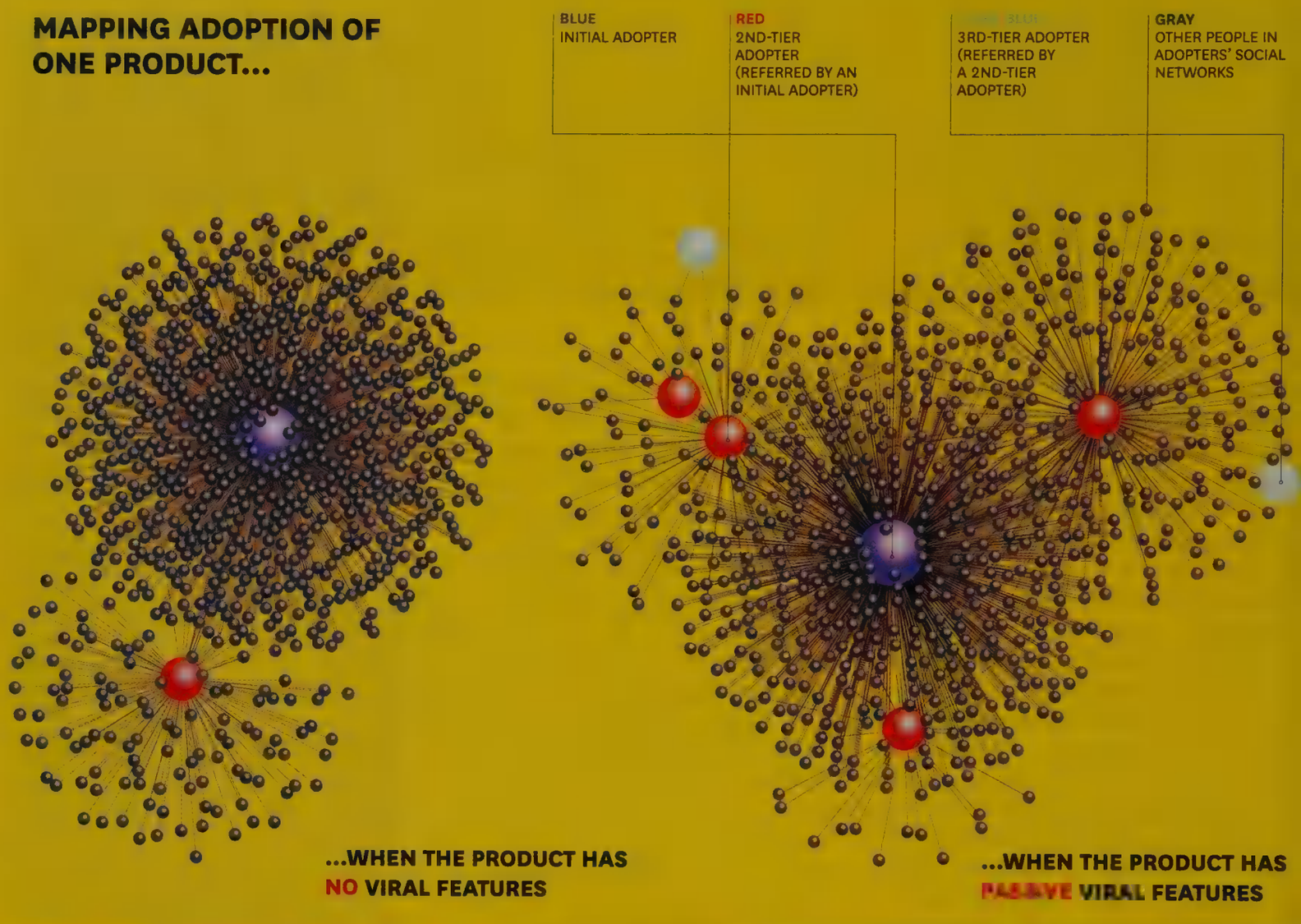
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Vision Statement

Sinan Aral is an assistant professor and **Dylan Walker** is a research scientist at New York University's Stern School of Business. This research is drawn from a paper forthcoming in *Management Science*.



Forget Viral Marketing— Make the Product Itself Viral

Don't spend your time saturating YouTube with goofy videos, hoping one of them will be the next viral marketing sensation. Research we conducted with the marketing analytics firm Social Amp proves that you can engineer digital (and even physical) products to increase peer-to-peer promotion. The graphics above illustrate the explosive effect on adoption among 2 million Facebook users when viral features, such as user-generated personalized invitations, were added to a software app for sharing and discussing film-industry information.

by **Sinan Aral** and **Dylan Walker**

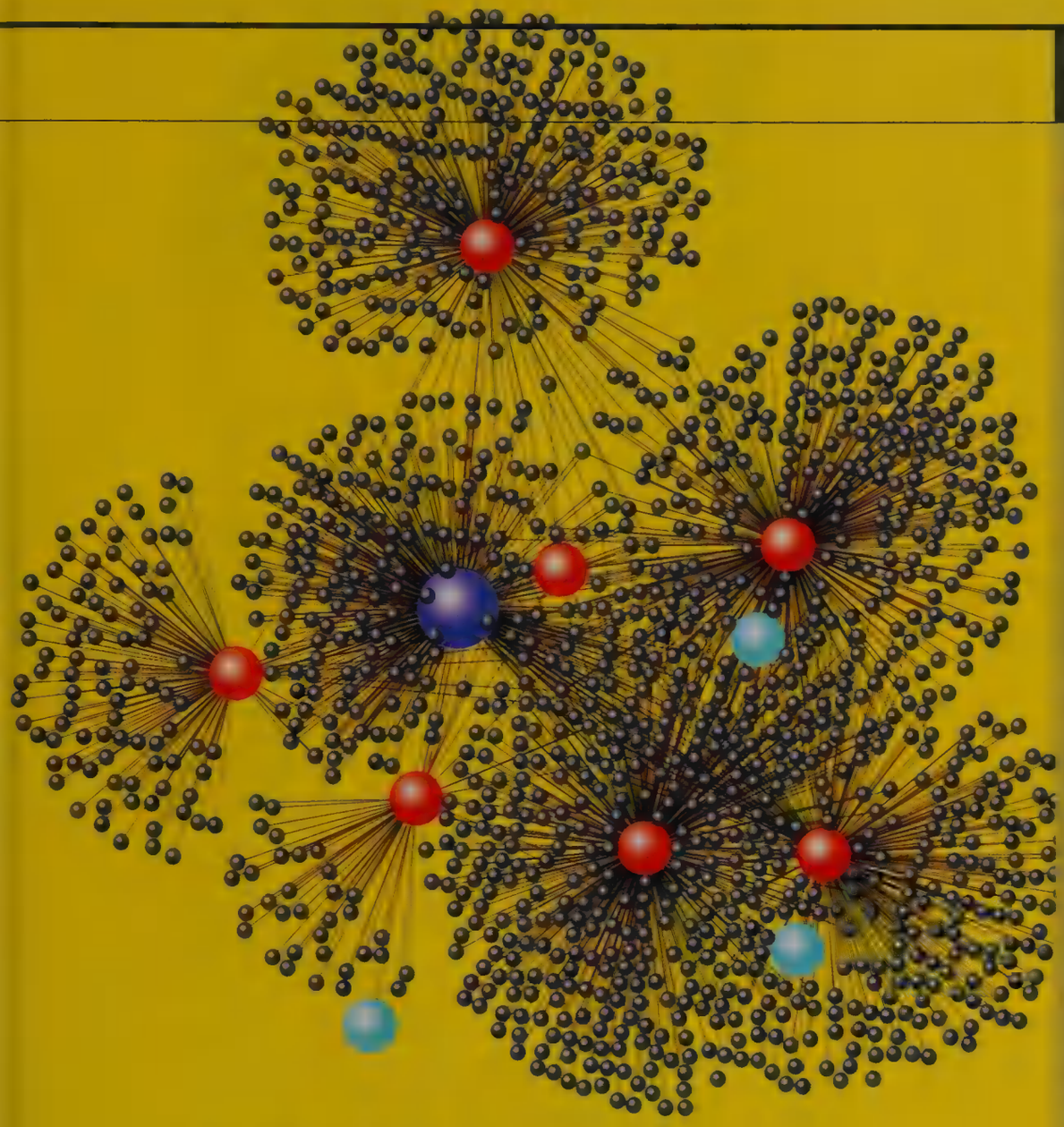
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400%

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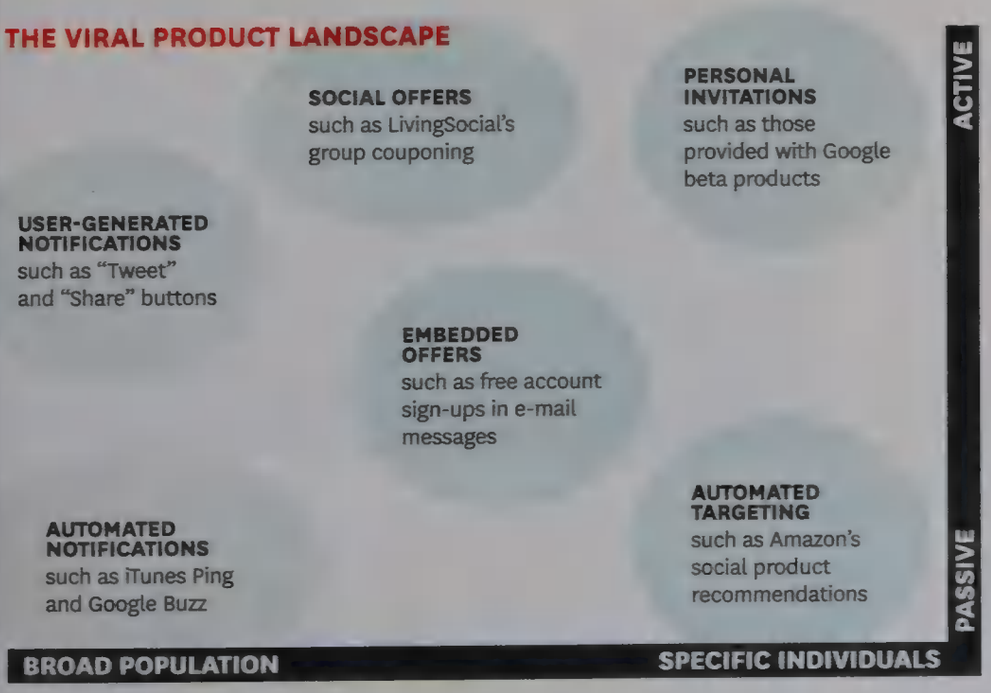


...WHEN THE PRODUCT HAS
ACTIVE AND PASSIVE VIRAL FEATURES

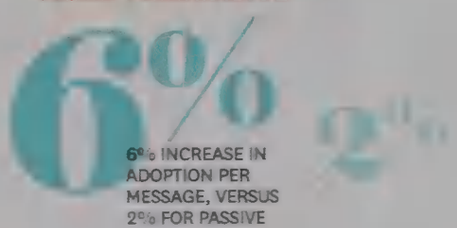
Viral Features

Passive	Active
PROS	**PROS**
Broader reach	Personalized to be more persuasive and more effective
More messages sent, and thus more adoption	Generates more user engagement, longer use of the product, and less churn by adopters
Reaches a more heterogeneous population	
CONS	**CONS**
Less effective per message	Narrower reach
Generates less user engagement, shorter use of the product, and more churn by adopters	Fewer messages sent, and thus less adoption
The social cost of annoying people	Reaches a more homogeneous population
USE IT TO	**USE IT TO**
Spread the word about a product widely	Build a loyal customer base
Generate adoption quickly	Make a product sticky
	Increase user engagement

THE VIRAL PRODUCT LANDSCAPE

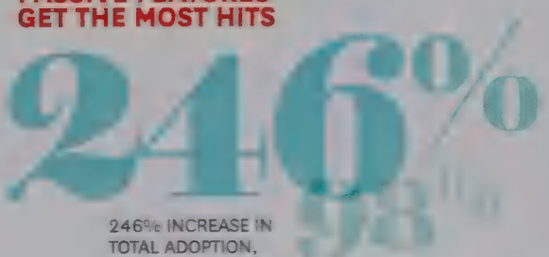


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1
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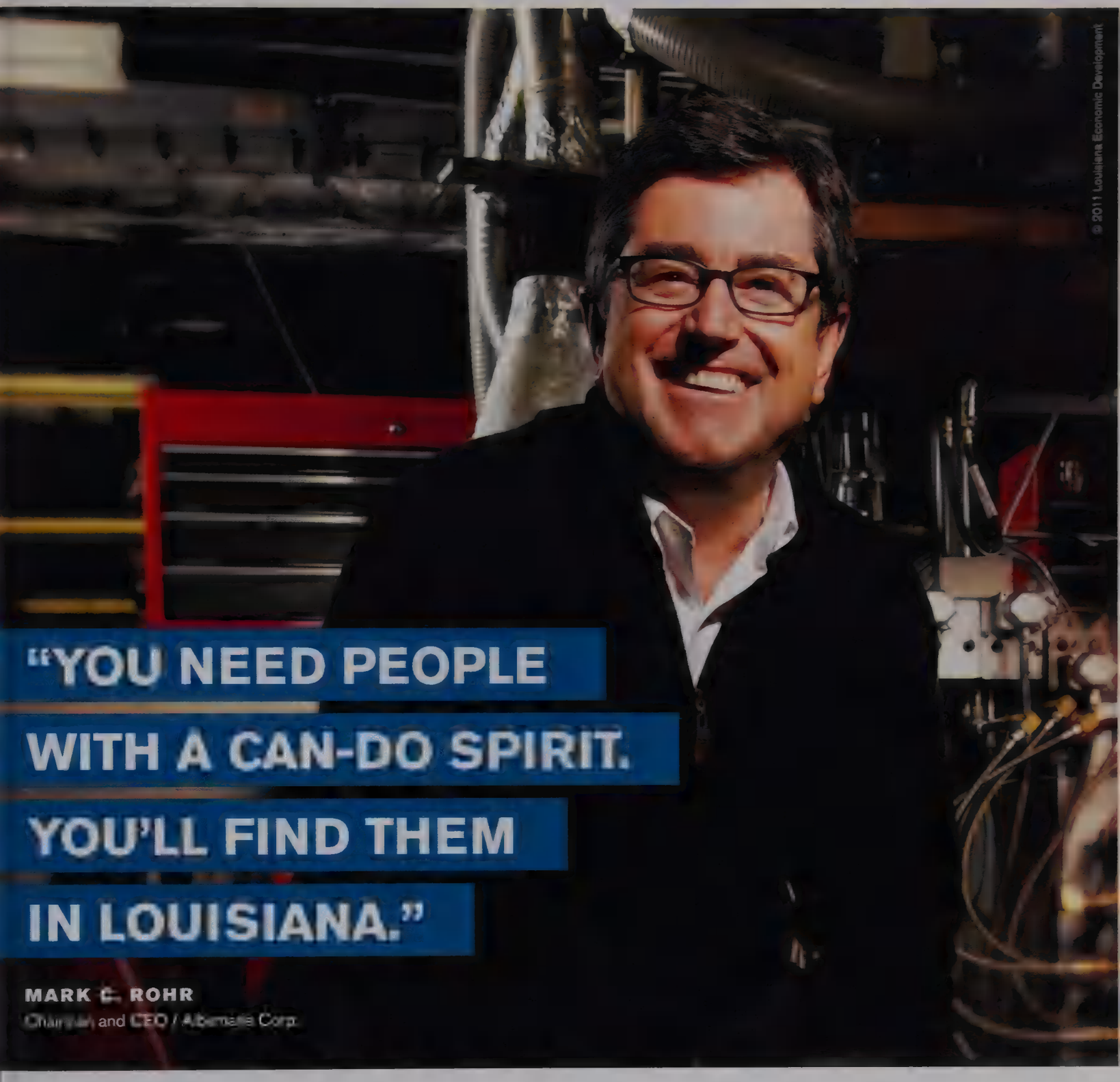


CAPTION CONTEST



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Sutton



Robert Sutton is a professor of management science and engineering at Stanford University and the author of *Good Boss, Bad Boss* (Business Plus, 2010).

On Stepping Down Gracefully



Some CEOs of long tenure must have gotten a slightly queasy feeling as they watched the recent events in the Arab world. Even if they bear no resemblance at all to Hosni Mubarak or Muammar Qaddafi—even if they are the most competent and benevolent of leaders—they may well feel horror at how rapidly the fortunes of a comfortable autocrat can disintegrate. They may wonder at the frightening human tendency, when the writing is on the wall, to resort to the denial, delusions, anger, and antics we've seen from these despots.

Such examples suggest that in one's hour of humiliation, it is mighty difficult to follow the obvious advice: If the end is inevitable, the only sane strategy is to salvage your reputation. How you handle yourself during your final months and weeks in power will have a big impact on how you are remembered.

In fact, research by the Nobel Prize winner Daniel Kahneman suggests it will have a *determinative* impact. Through a series of experiments, he established that people's memories of experiences are shaped by peak moments, whether good or bad, and by how those experiences ended. This "peak-end rule" holds a lesson for office leavers—whether they are being forced out or have chosen to move on. Since it will be too late when you're on the way out the door to change the peaks of your tenure, your only remaining shot at affecting how you'll be judged by history is to create a favorable impression with your exit.

Will you be remembered as a selfish narcissist or a selfless steward? The people you work with—your charges, peers, bosses, clients, and customers—will recall the first of these images if you devoted your final days to bragging about your accomplishments, grabbing goodies for yourself, and settling personal scores. They will recollect the second if they saw you thanking those who helped you, encouraging customers to remain loyal, and even mending fences with old adversaries.

Be aware that people will devote particular attention to how you interact with your successor. They will judge whether your congratulations are authentic. They will scrutinize your body language, noting how close you stand, how sincerely you smile, and whether you appear interested, bored, or disdainful when your successor is speaking. In the special case of a CEO who is retiring to the chairmanship, they will also note whether you show deference to and respect for the new boss or treat him or her as the same old underling—by interrupting, for example, or lecturing, or insisting on having the last word.

How you handle yourself during your final months and weeks in power will have a big impact on how you are remembered.

David Kelley, a founder of IDEO, is one ex-CEO who has impressed me in this regard. Shortly after he stepped up to chairman and Tim Brown became CEO, I took part in an IDEO off-site meeting. I couldn't help noticing the difference in David's behavior: He spent most of three days standing at the back of the room, listening carefully but only rarely making comments. I mentioned that it was a change from my previous observations of him. He said it was Tim's show now, and his job was to get out of the way.

That's an incident I still think and tell about, and I've since heard other IDEO folks mention David's gracious behavior during the transition. I guess that makes it a great example of the peak-end rule: Many of us carry a flattering picture of David. His graceful exit only helped to color his legacy as IDEO's founder and former CEO.

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Simester



Duncan Simester is the NTU Professor of Management Science at MIT's Sloan School of Management.

When You Shouldn't Listen To Your Critics

Six years ago two partners and I opened a small grab-and-go food business. The store was their idea, and it was a smart one: Nobody nearby was offering high-quality prepared meals. The business (which I won't name because my partners prefer to stay out of the spotlight) has done well. Many customers adore our food. But if you go online, you might think otherwise.

That's because of another business that took root around the same time: Yelp, a website that allows users to rate and review all kinds of service businesses, from restaurants to moving companies to churches. Yelp's business model, like those of TripAdvisor and IMDb, relies on user-generated reviews. And, as online retailers have learned, comments can have a big impact on customers' decisions. Think about it: How often do you check reviews before buying on Amazon?

For managers, this creates both an opportunity and a dilemma. In theory, customer feedback, whether positive or negative, is a good thing, because it allows a business to improve. In reality, it can be hard to figure out what kind of feedback is legitimate—and how responsive to be. In both my consulting work and my executive teaching, I'm asked about this issue frequently.

When we were getting started, my partners and I obsessed over Yelp reviews. It hurt when someone wrote, "If you have money to spare, I suppose you could do worse." We were tempted to rethink our model when one critic complained, "The prices are seriously whacked—$6 for...basically schmancy gas station food." We have plenty of good reviews, too, but even today our Yelp rating is just three out of five stars.

It's hard to ignore feedback, especially when it is so frank. But because the reviewers in social media are usually anonymous, it's hard to know whether they are representative. In 2009 we had a rare opportunity to meet some of them.



In theory, feedback is good. In reality, it can be hard to figure out which reviews are legitimate—and how responsive to be.

That fall we attended an event where Yelp hosted several hundred "elite users"—the volunteers who write many of its reviews. As we handed out (free) food, I realized that these people looked nothing like our customers, who tend to be over 30 and professional. The Yelpers were mostly in their twenties. From my conversations that evening, I learned that most of them don't want to pay premium prices for premium food. Economically, that makes sense. They are apparently less affluent than our customers. They may have many motivations for writing free reviews, but they are likely to have ample spare time and to be highly price sensitive—factors that undoubtedly color their postings.

Of course, anonymity is not always the case. One catalog retailer I have worked with matches its online reviewers with their order histories. It, too, has found that they aren't representative of its customer base: They tend to make smaller purchases and to buy a higher proportion of sale and clearance items. The retailer still monitors online reviews and is quite responsive to complaints about product defects—but it doesn't worry much about price complaints.

If businesses all try to please the same segment of reviewers, they risk forgoing the differentiation that comes from targeting specific markets. As we've learned this lesson in our business, we've increased our investment in traditional focus groups to ensure that we respond to the needs of our core market. That doesn't mean we ignore online feedback—indeed, we even welcome it from one-shot customers, who may someday come to appreciate our premium niche. But when a reviewer says that the price of a $6 sandwich is "seriously whacked," I have a better understanding of what—and who—is behind it.

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*U.S. Energy Information Administration, International Energy Outlook 2010.

† U.S. Energy Information Administration, Annual Energy Outlook 2011 with Projections to 2035 (time period for calculation is 2007 to 2035).

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How I Did It...

Pramod Bhasin is the chief executive officer of Genpact.

Genpact's CEO on Building an Industry In India from Scratch



by Pramod Bhasin

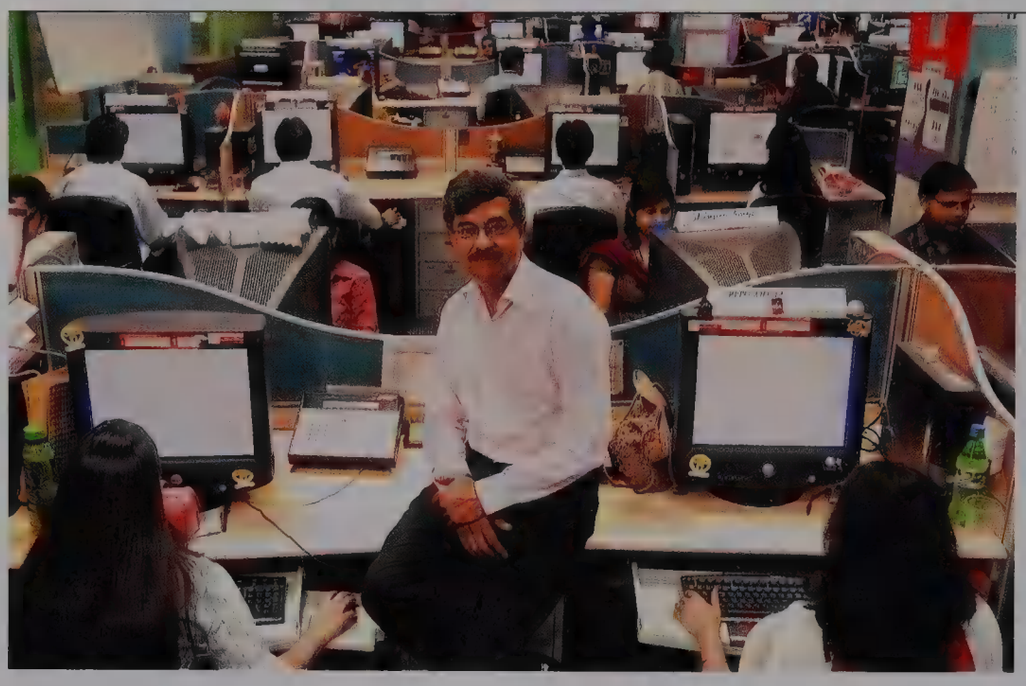
THE IDEA

As the head of GE Capital in India, Bhasin found its growth hamstrung by government bureaucracy. Then he had a vision—he could offer back-office services across GE Capital. It was the beginning of Genpact—and of an entire industry.

For several months in the late 1990s, I was inundated with phone calls from competitors and other companies that wanted to visit the offices of GE Capital in India. Taking competitors on tours of the facilities isn't among the responsibilities of most top executives—indeed, it isn't done at all. But I agreed because I viewed the requests from such companies as Standard Chartered Bank, Bank of America, and Accenture as a sign that we were on the cusp of something incredible.

And we were. Today my company, Genpact, handles business process management and employs 43,000 people around the world. It also indirectly contributes, we believe, to the employment of another million people, who work in businesses that support us and our employees. We are in 13 countries and we operate 39 facilities serving 400 other companies. Genpact spun off from its parent company, GE Capital, in 2005 and is now a $1.26 billion publicly traded company.

But 13 years ago it was little more than a small division of GE Capital. Then the head of GE Capital in India, I was trying to find ways to grow the business. At that time the division was the first 100% foreign-owned financial services company that had been



I could see an eager, ambitious talent pool all around me. Why not take advantage of it to build our business?

allowed into India. In our effort to create a local market, we were providing back-office services such as processing car loans and credit card transactions. India had just begun to open its borders—we were, in effect, an experiment by the government. But I could see how vulnerable the business was to changes in government policy and philosophy. We were hamstrung by regulations and red tape. When Indian banks faced a liquidity crisis, the government asked them not to lend to us, because it assumed that our borrowing from them was contributing to the liquidity problem. I recognized that a single regulatory stroke could change the dynamics of our organization completely. And it was hard to build a sustainable business that was so dependent on regulations under the government's control.

At the same time, I could see on a daily basis that an eager, ambitious talent pool existed both within the company and across India. Why not take advantage of it to build our business? We could expand our back-office support services to GE Capital all over the world.

I remember asking a handful of people I trusted if this idea was feasible. All of them said, unequivocally, no. What I was talking about would require building a large-scale facility unlike anything that existed in the region; hiring huge numbers of people and training them to Six Sigma standards on products they knew nothing about; persuading regional and national governments and telecommunications companies to set up and ensure service and infrastructure at a level unheard of in India; and creating an entire business ecosystem.

The concerns that were expressed ranged from the extreme (a terrorist attack would take us out) to the thoughtful—some of which I'd anticipated, such as that mission-critical processes might fail in our hands, or that if we messed things up, we might destroy the whole company's supply chain. Some people within GE worried that we'd be stripping out a critical layer of judgment—middle management. We would lose crucial records. They also had simple concerns that were easily dismissed, such as whether we would be able to set up modern offices and hire people who spoke English. But many concerns were valid and would require extremely careful planning on my part.

Completely Uncharted Territory

It was a nearly unimaginable undertaking. Many things could go wrong. So, I thought, we would need a foolproof plan. We'd have to think defensively—to get ahead of any real concerns.

I didn't do any business plan modeling or studies to prove that an opportunity existed. To me, it was obvious. I knew that if we could get sophisticated technology to support us—a very big if in India at the time—we had the raw talent to offer our services at a small fraction of the cost elsewhere. So in 1997 I approached Gary Wendt, who then headed GE Capital, for money to launch a pilot project. He gave me the princely sum of $2 million to make it work.

In hindsight, getting the initial investment was the easy part. (We eventually spent closer to $5 million on the start-up costs.) We had virtually nothing in place to make such a global operation work. We couldn't just sit down and do the proper analysis to plan it, because this was completely uncharted territory. We did draw up a business plan, but there was so much finger-in-the-air stuff that I don't think it had much credibility. We didn't even know at the start how big the venture could be. We just said, "Let's light a fire and see what happens." We did know, however, that given the low costs of highly educated labor in India, we could probably build an operation that would save GE Capital 30% to 50% of what it was then spending on similar services. That was really the essence of our business plan. It was also pretty much all we knew.

Having a few people trained to provide minor back-office support for a nascent Indian market was a far cry from handling a large volume of work and calls from all over the world at any time of day. We needed to conceive the entire operation from scratch. We decided that we had to become very good, very quickly, at four key elements: hiring the right people, training them, building a tool kit to replicate our learning in other parts of the world and to move pro-

cesses from one location to another, and embedding Six Sigma quality controls in our operation from day one. We would be a beta site with the potential for huge growth at GE Capital—if we got it right.

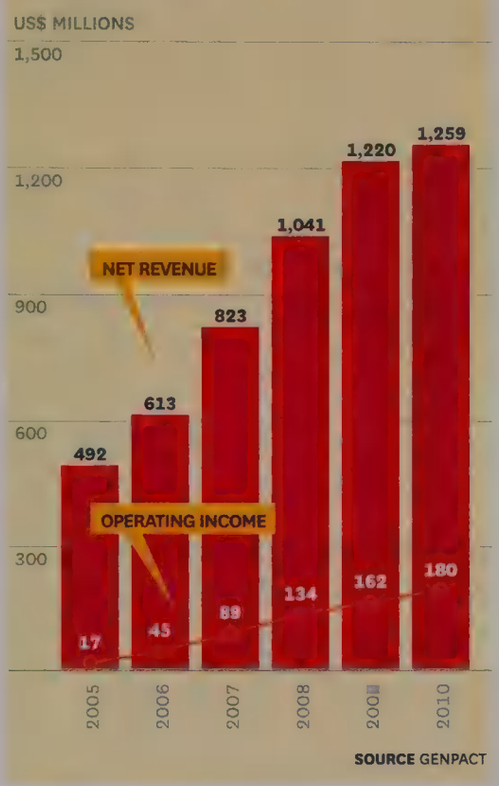
We had no expertise in recruiting and training the people we'd need for the work. And the products they'd be supporting, such as mortgages and credit cards, were completely foreign to most of our potential employees; training would have to begin at an extremely basic level. Even more challenging, we'd first have to train our trainers. No Indian trainers knew about mortgages and the other sophisticated financial products GE Capital offered the public. They didn't even have the knowledge of such products that we take for granted in America—how credit cards work, who pays the money and when, how a plastic card leads to someone's bank account. We had to teach them everything. The gulf between what they knew and what they were going to be employed to do was enormous. One of the best things I did right up front was recruit Raman Roy from American Express. He had already built a small back office for AmEx and knew what would be required. He led our efforts during the early years with great creativity and problem-solving skills.

But what I was most afraid of was that the head office wouldn't consider our operation to be of sufficient quality. So we set out to avoid failure at all costs. Every scrap of work had double or triple checks before it went out the door.

We had to literally build the infrastructure around us. We started on the floor of our existing office building in Gurgaon, which was about 8,000 square feet. There were many other hurdles—some enormous, some basic. One of the biggest was creating a reliable telecom system in a country that was far from modernized. We set up multiple phone lines to make sure we had backups in case of any possible problems. To ensure service, we installed the first satellite dish on a commercial building in India. We had to figure out how to sufficiently soundproof the cubicles for workers who would constantly be on the phone. We began by asking people to bring curtains and saris from home. In hindsight, it was pretty funny. But we were trying to be creative with our limited resources.

GENPACT'S FIRST SIX YEARS

Since its spin-off from GE Capital, the company has grown steadily.



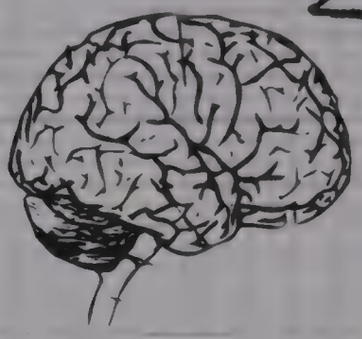
SOURCE GENPACT

"Trespassers Will Be Recruited!"

Considering the intensity of the buildup, the day we went live with our staff, in late 1998, was fairly mundane. We weren't doing anything on the phones. We were handling what's known as white mail—paper that comes to credit card operations about things like changes of address. Before we set up our operation, these very simple tasks would have been handled in much higher-cost locations in the U.S. It didn't take long for our project to gain momentum. We'd had 8,000 applications for our first 20 jobs; 5,000 of the applicants were clearly eligible. By the following year we had 300 employees. Raman Roy actually put up a sign outside our building that said "Trespassers will be recruited!" We began to handle increasingly complex back-office support, such as mortgage applications, auto loan approvals, disbursals, and accounting transactions.

With people coming on staff so quickly, we needed all kinds of attendant services

2



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A Parallel Success in Genpact's Supply Chain

In the late 1990s, when Satish Sehrawat was first asked to provide transportation for Genpact (then GE Capital), he owned three cars and had only sporadic work. Now his company, Ten Travels, has 300 cars, 40 buses, and 600 employees. "[Such rapid growth] was not even dreamed of," he says.

Early on, Sehrawat's car service became part of Genpact's recruitment pitch: It would transport the burgeoning numbers of employees to and from work. "No one knew what outsourcing really was at the time," he recalls. He had to scramble to keep up with Genpact's needs—fitting his cars with wireless and GPS technology, for example, to minimize commuting time. Genpact gave him interest-free funding. The company also helps Sehrawat retain the best possible drivers for 24/7 shifts by offering them a monthly bonus of 1,000 rupees—10% of their base salary—if they drive primarily for Genpact.

Whereas he once dreamed of owning a Mercedes, Sehrawat now has a whole fleet of them—good fortune that is not lost on him. "I'm not on Genpact's payroll," he says, "but in every cell of my body you will find Genpact written."

Next on his wish list is a helicopter, something he has asked Genpact to consider financing. Awaiting CEO Pramod Bhasin's decision, he reports: "I'm keeping my fingers crossed. Put in a good word."

—Karen Dillon

that we hadn't originally anticipated. We had to have vans and SUVs to transport employees to and from work at all hours—requiring a level of organization then unknown in India. (To this day we offer transportation to 15,000 workers.) We had to provide food for a 24-hour rotating staff of what would become 4,000 people on any given shift—working in an undeveloped suburb that offered no facilities and constructing business continuity plans from scratch. And we had to demonstrate to customers and recruits (and their families, who had concerns about their children's involvement in the operation) that this would really work.

That's what led to our willingness to give tours of what we were building. Every time people walked through our facilities, they were impressed by the size and sophistication of our operation. We learned how to tell our story very well—not only to the GE brass and competitors (we eventually stopped allowing the latter into our facility) but also to the people we would be relying on to create support services like that round-the-clock transportation. We actually created "prospective parents' days" so that the parents of the young, single women we were frequently hiring could see their daughters' workplace.

> We knew we had a tiger by the tail, because demand surged—not just from GE businesses but from other companies.

How Do You Spell That?

We knew we had a tiger by the tail, because demand surged—not just from GE businesses but from other companies that had heard about what we were doing. It was the beginning of an entirely new industry in India. In 1998 we had 20 people doing this work. By 2001 we had 12,000. We were trying to hire and train a thousand people a month, and the pressure on us was very high. Our work was increasingly mission-critical for GE, and I feared that at the pace we were growing, quality would decline. It did.

We started providing new services for different GE divisions, but at some point our breakneck expansion was just too much. Often we weren't at our best on calls handling products and services that were new to our group. Once, the vice chairman of GE had a problem with his computer and was put through to our help desk in India. The customer support person asked him where he was calling from, and when he said Fairfield, Connecticut—well-known as GE's headquarters—our guy asked him how to spell it. Believe me, I heard about that. It seemed as if we were not on top of our game—and we weren't. Looking back, I sometimes find these stories hilarious, but then I knew we had to slam on the brakes and get this stuff right.

With that fast-paced growth, attrition also began to soar, reaching 50%. Our hiring engine wasn't good enough to replace that many employees every year, never mind train them to Six Sigma standards. So we had to pull back. We deliberately stopped growing for a full year, from 2001 to 2002, in order to get a handle on quality again. It was obvious that we had some issues, because our clients were talking about them. That year, when the world's markets were skittish after 9/11, we stopped all hiring, redoubled our training of managers, and rethought our training processes until we felt we had achieved better quality control.

That was a useful pause in our exponential growth, because it enabled me to develop a vision of where the business should go in the future. It was clear to me that the potential lay in expanding our services beyond just one customer. By 2002 we were back in growth mode. We now have operations all over the world, including Dalian, which is considered the outsourcing hub for China.

Back in the beginning, I knew we were on to something incredibly exciting, but even I am surprised at how enormous and game-changing our growth turned out to be. We helped spawn an entire industry of business process outsourcing in India—though we are still the leader in terms of revenue. As I look around at the physical transformation of the towns in which we operate, I'm proud of what those early-stage ideas turned into. When we first started building in Gurgaon, you couldn't buy a decent coffee or tea or sandwich. It's now a thriving community five times the size of Hoboken. And all that has been built on the shoulders of those initial 20 hires we made in 1997. I don't know how many people get an opportunity to lead that kind of transformation in their lifetimes.

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"YOU CAN APPLY EVERYTHING BACK TO YOUR COMPANY. THESE ARE LESSONS YOU WILL ALWAYS REMEMBER."

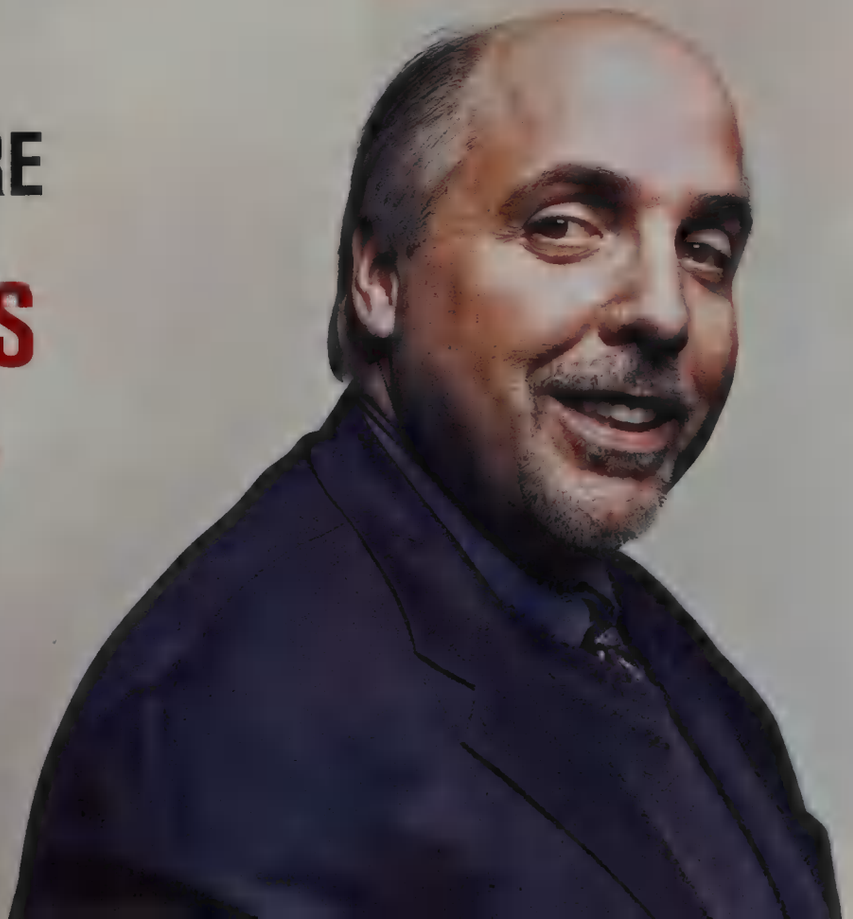
–Sreeja Kartha
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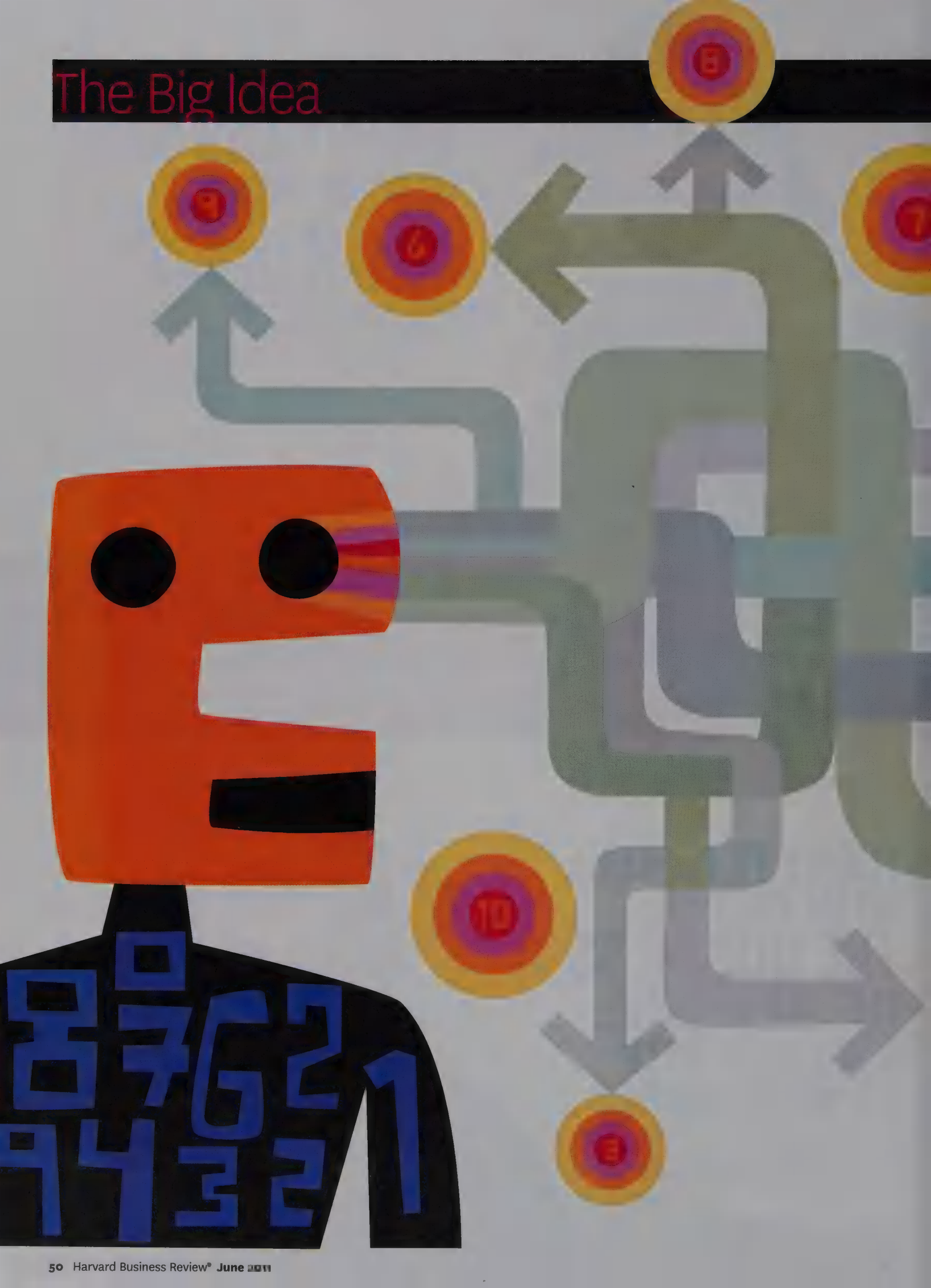
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"I CAME TO EXPLORE WHAT DRIVES THE BUSINESS OF MEDICINE. BUT I LEFT WITH SO MUCH MORE."

–Dr. Michael Jaff
General Management Program 2010



Learn More





Dangerous biases can creep into every strategic choice. Here's how to find them—before they lead you astray. *by Daniel Kahneman, Dan Lovallo, and Olivier Sibony*

Before You Make That Big Decision...

THANKS TO a slew of popular new books, many executives today realize how biases can distort reasoning in business. *Confirmation bias,* for instance, leads people to ignore evidence that contradicts their preconceived notions. *Anchoring* causes them to weigh one piece of information too heavily in making decisions; *loss aversion* makes them too cautious. In our experience, however, awareness of the effects of biases has done little to improve the quality of business decisions at either the individual or the organizational level.

Though there may now be far more talk of biases among managers, talk alone will not eliminate them. But it is possible to take steps to counteract them. A recent McKinsey study of more than 1,000 major business investments showed that when organizations worked at reducing the effect of bias in their decision-making processes, they achieved returns up to seven percentage points higher. (For more on this study, see "The Case for Behavioral Strategy," *McKinsey Quarterly,* March 2010.) Reducing bias makes a difference. In this article, we will describe

THE BEHAVIORAL ECONOMICS OF DECISION MAKING

Daniel Kahneman (the lead author) and Amos Tversky introduced the idea of cognitive biases, and their impact on decision making, in 1974. Their research and ideas were recognized when Kahneman was awarded a Nobel Prize in economics in 2002. These biases, and behavioral psychology generally, have since captured the imagination of business experts. Below are some notable popular books on this topic:

Nudge: Improving Decisions About Health, Wealth, and Happiness
by Richard H. Thaler and Cass R. Sunstein (Caravan, 2008)

Think Twice: Harnessing the Power of Counterintuition
by Michael J. Mauboussin (Harvard Business Review Press, 2009)

Think Again: Why Good Leaders Make Bad Decisions and How to Keep It from Happening to You
by Sydney Finkelstein, Jo Whitehead, and Andrew Campbell (Harvard Business Review Press, 2009)

Predictably Irrational: The Hidden Forces That Shape Our Decisions
by Dan Ariely (HarperCollins, 2008)

Thinking, Fast and Slow
by Daniel Kahneman (Farrar, Straus and Giroux, forthcoming in 2011)

a straightforward way to detect bias and minimize its effects in the most common kind of decision that executives make: reviewing a recommendation from someone else and determining whether to accept it, reject it, or pass it on to the next level.

For most executives, these reviews seem simple enough. First, they need to quickly grasp the relevant facts (getting them from people who know more about the details than they do). Second, they need to figure out if the people making the recommendation are intentionally clouding the facts in some way. And finally, they need to apply their own experience, knowledge, and reasoning to decide whether the recommendation is right.

However, this process is fraught at every stage with the potential for distortions in judgment that result from cognitive biases. Executives can't do much about their own biases, as we shall see. But given the proper tools, they can recognize and neutralize those of their teams. Over time, by using these tools, they will build decision processes that reduce the effect of biases in their organizations. And in doing so, they'll help upgrade the quality of decisions their organizations make.

The Challenge of Avoiding Bias

Let's delve first into the question of why people are incapable of recognizing their own biases.

According to cognitive scientists, there are two modes of thinking, intuitive and reflective. (In recent decades a lot of psychological research has focused on distinctions between them. Richard Thaler and Cass Sunstein popularized it in their book, *Nudge*.) In intuitive, or System One, thinking, impressions, associations, feelings, intentions, and preparations for action flow effortlessly. System One produces a constant representation of the world around us and allows us to do things like walk, avoid obstacles, and contemplate something else all at the same time. We're usually in this mode when we brush our teeth, banter with friends, or play tennis. We're not consciously focusing on how to do those things; we just do them.

In contrast reflective, or System Two, thinking is slow, effortful, and deliberate. This mode is at work when we complete a tax form or learn to drive. Both modes are continuously active, but System Two is typically just monitoring things. It's mobilized when the stakes are high, when we detect an obvious error, or when rule-based reasoning is required. But most of the time, System One determines our thoughts.

Our visual system and associative memory (both important aspects of System One) are designed to produce a single coherent interpretation of what is going on around us. That sense making is highly sensitive to context. Consider the word "bank." For most people reading HBR, it would signify a financial institution. But if the same readers encountered this word in *Field & Stream,* they would probably understand it differently. Context is complicated: In addition to visual cues, memories, and associations, it comprises goals, anxieties, and other inputs. As System One makes sense of those inputs and develops a narrative, it suppresses alternative stories.

Because System One is so good at making up contextual stories and we're not aware of its operations, it can lead us astray. The stories it creates are generally accurate, but there are exceptions. Cognitive biases are one major, well-documented example. An insidious feature of cognitive failures is that we have no way of knowing that they're happening: We almost never catch ourselves in the act of making intuitive errors. Experience doesn't help us recognize them. (By contrast, if we tackle a difficult problem using System Two thinking and fail to solve it, we're uncomfortably aware of that fact.)

This inability to sense that we've made a mistake is the key to understanding why we generally accept our intuitive, effortless thinking at face value. It also explains why, even when we become aware of the existence of biases, we're not excited about eliminating them in ourselves. After all, it's difficult for us to fix errors we can't see.

By extension, this also explains why the management experts writing about cognitive biases have not provided much practical help. Their overarching theme is "forewarned is forearmed." But knowing you have biases is not enough to help you overcome them. You may accept that you have biases, but you cannot eliminate them in yourself.

There is reason for hope, however, when we move from the individual to the collective, from the decision maker to the decision-making process, and from the executive to the organization. As researchers have documented in the realm of operational management, the fact that individuals are not aware of their own biases does not mean that biases can't be neutralized—or at least reduced—at the organizational level.

This is true because most decisions are influenced by many people, and because decision makers can turn their ability to spot biases in others' thinking to

Idea in Brief

When executives make big strategic bets, they typically depend on the judgment of their teams to a significant extent.

The people recommending a course of action will have delved more deeply into the proposal than the executive has time to do.

Inevitably, lapses in judgment creep into the recommending team's decision-making process (because its members fell in love with a deal, say, or are making a faulty comparison to an earlier business case).

This article poses 12 questions that will help executives vet the quality of decisions and think through not just the content of the proposals they review but the biases that may have distorted the reasoning of the people who created them.

their own advantage. We may not be able to control our own intuition, but we can apply rational thought to detect others' faulty intuition and improve *their* judgment. (In other words, we can use our System Two thinking to spot System One errors in the recommendations given to us by others.)

This is precisely what executives are expected to do every time they review recommendations and make a final call. Often they apply a crude, unsystematic adjustment—such as adding a "safety margin" to a forecasted cost—to account for a perceived bias. For the most part, however, decision makers focus on *content* when they review and challenge recommendations. We propose adding a systematic review of the recommendation *process,* one aimed at identifying the biases that may have influenced the people putting forth proposals. The idea is to retrace their steps to determine where intuitive thinking may have steered them off-track.

In the following section, we'll walk you through how to do a process review, drawing on the actual experiences of three corporate executives—Bob, Lisa, and Devesh (not their real names)—who were asked to consider very different kinds of proposals:

A radical pricing change. Bob is the vice president of sales in a business services company. Recently, his senior regional VP and several colleagues recommended a total overhaul of the company's pricing structure. They argued that the company had lost a number of bids to competitors, as well as some of its best salespeople, because of unsustainable price levels. But making the wrong move could be very costly and perhaps even trigger a price war.

A large capital outlay. Lisa is the chief financial officer of a capital-intensive manufacturing company. The VP of manufacturing in one of the corporation's business units has proposed a substantial investment in one manufacturing site. The request has all the usual components—a revenue forecast, an analysis of return on investment under various scenarios, and so on. But the investment would be a very large one—in a business that has been losing money for some time.

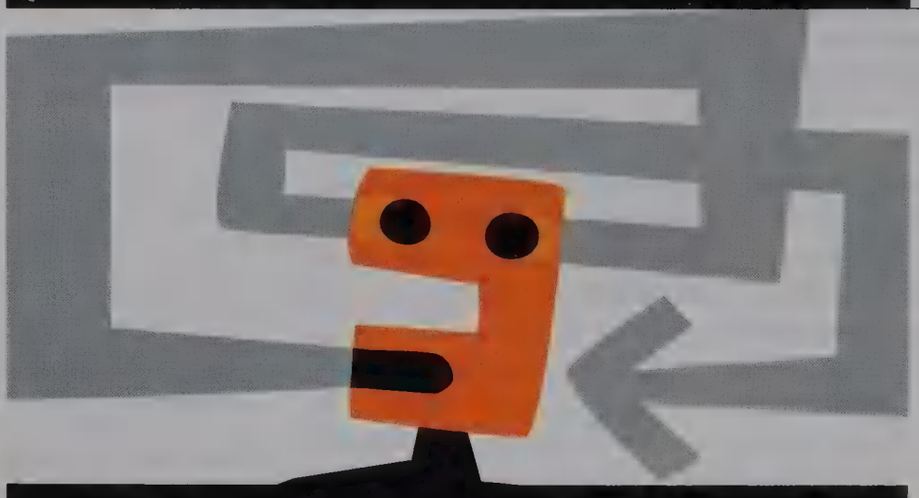
A major acquisition. Devesh is the CEO of a diversified industrial company. His business development team has proposed purchasing a firm whose offerings would complement the product line in one of the company's core businesses. However, the potential deal comes on the heels of several successful but expensive takeovers, and the company's financial structure is stretched.

While we are intentionally describing this review from the perspective of the individual decision makers, organizations can also take steps to embed some of these practices in their broader decision-making

THREE EXECUTIVES FACING VERY DIFFERENT DECISIONS



PRELIMINARY QUESTIONS



Ask yourself

1

CHECK FOR SELF-INTERESTED BIASES

Is there any reason to suspect the team making the recommendation of errors motivated by self-interest?

Review the proposal with extra care, especially for overoptimism.

2

CHECK FOR THE AFFECT HEURISTIC

Has the team fallen in love with its proposal?

Rigorously apply all the quality controls on the checklist.

3

CHECK FOR GROUPTHINK

Were there dissenting opinions within the team?

Were they explored adequately?

Solicit dissenting views, discreetly if necessary.

processes. (For the best ways to approach that, see the sidebar "Improving Decisions Throughout the Organization.")

Decision Quality Control: A Checklist

To help executives vet decisions, we have developed a tool, based on a 12-question checklist, that is intended to unearth defects in thinking—in other words, the cognitive biases of the teams making recommendations. The questions fall into three categories: questions the decision makers should ask themselves, questions they should use to challenge the people proposing a course of action, and questions aimed at evaluating the proposal. It's important to note that, because you can't recognize your own biases, the individuals using this quality screen should be completely independent from the teams making the recommendations.

Questions that decision makers should ask themselves

1. Is there any reason to suspect *motivated errors*, or errors driven by the self-interest of the recommending team? Decision makers should never directly ask the people making the proposal this. After all, it's nearly impossible to do so without appearing to question their diligence and even their integrity, and that conversation cannot end well.

The issue here is not just intentional deception. People do sometimes lie deliberately, of course, but self-deception and rationalization are more common problems. Research has shown that professionals who sincerely believe that their decisions are "not for sale" (such as physicians) are still biased in the direction of their own interests.

Bob, for instance, should recognize that lowering prices to respond to competitive pressures will have a material impact on the commissions of his sales team (especially if bonuses are based on revenues, not margins). Devesh should wonder whether the team recommending the acquisition would expect to run the acquired company and therefore might be influenced by "empire building" motives.

Of course, a preference for a particular outcome is built into every recommendation. Decision makers need to assess not whether there's a risk of motivated error but whether it is significant. A proposal from a set of individuals who stand to gain more than usual from the outcome—either in financial terms or, more frequently, in terms of organizational power, reputation, or career options—needs especially careful quality control. Reviewers also should watch out for pernicious sets of options that include only one realistic alternative—the one that the recommending team prefers. In such cases, decision makers will have to pay even more attention to the remaining questions on this checklist, particularly those covering optimistic biases.

2. Have the people making the recommendation fallen in love with it? All of us are subject to the *affect heuristic:* When evaluating something we like, we tend to minimize its risks and costs and exaggerate its benefits; when assessing something we dislike, we do the opposite. Executives often observe this phenomenon in decisions with a strong emotional component, such as those concerning employees, brands, or locations.

This question is also best left unspoken but is usually easy to answer. It is likely that Devesh will easily sense whether the members of the deal team have maintained a neutral perspective regarding the acquisition. If they have become emotional about it, the remedy, again, is to examine with extra thoroughness all the components of the recommendation and all the biases that may have affected the people making it.

3. Were there dissenting opinions within the recommending team? If so, were they explored adequately? In many corporate cultures, a team presenting a recommendation to a higher echelon will claim to be unanimous. The unanimity is sometimes genuine, but it could be sham unity imposed by the team's leader or a case of groupthink—the tendency of groups to minimize conflict by converging on a decision because it appears to be gathering support. Groupthink is especially likely if there is little diversity of background and viewpoint within a team. Lisa, for instance, should worry if no one in the manufacturing team that is proposing the large investment has voiced any concerns or disagreement.

Regardless of its cause, an absence of dissent in a team addressing a complex problem should sound an alarm. In the long run, a senior executive should strive to create a climate where substantive disagreements are seen as a productive part of the decision process (and resolved objectively), rather than as a sign of conflict between individuals (and suppressed). In the short run, if faced with a recommendation in which dissent clearly was stifled, a decision maker has few options. Because asking another group of people to generate additional options is often impractical, the best choice may be to discreetly solicit dissenting views from members of the recommending team, perhaps through private meetings. And the opinions of those who braved the pressure for conformity in the decision-making process deserve special attention.

Questions that decision makers should ask the team making recommendations

4. Could the diagnosis of the situation be overly influenced by salient analogies? Many recommendations refer to a past success story, which the decision maker is encouraged to repeat by approving the proposal. The business development team advocating the acquisition to Devesh took this approach, using the example of a recent successful deal it had completed to bolster its case. The danger, of course, is that the analogy may be less relevant to the current deal than it appears. Furthermore, the use of just one or a few analogies almost always leads to faulty inferences.

People do sometimes lie deliberately, but self-deception and rationalization are more common problems.

The decision maker who suspects that an analogy to an especially memorable event has unduly influenced a team's judgment (a type of cognitive flaw known as *saliency bias*) will want the team to explore alternative diagnoses. This can be done by asking for more analogies and a rigorous analysis of how comparable examples really are. (For more details on the technique for doing this, called *reference class forecasting,* see "Delusions of Success: How Optimism Undermines Executives' Decisions," by Dan Lovallo and Daniel Kahneman, HBR July 2003.) More informally, a decision maker can simply prompt the team to use a broader set of comparisons. Devesh could ask for descriptions of five recent deals, other than the recently acquired company, that were somewhat similar to the one being considered.

5. Have credible alternatives been considered? In a good decision process, other alternatives are fully evaluated in an objective and fact-based way. Yet when trying to solve a problem, both individuals and groups are prone to generating one plausible hypothesis and then seeking only evidence that supports it.

A good practice is to insist that people submit at least one or two alternatives to the main recommendation and explain their pros and cons. A decision maker should ask: What alternatives did you consider? At what stage were they discarded? Did you actively look for information that would disprove your main hypothesis or only for the confirming evidence described in your final recommendation?

Some proposals feature a perfunctory list of "risks and mitigating actions" or a set of implausible alternatives that make the recommendation look appealing by contrast. The challenge is to encourage a *genuine* admission of uncertainty and a sincere recognition of multiple options.



Bob should encourage his sales team to evaluate other options, such as a targeted marketing program aimed at the customer segments in which the company has a competitive advantage.

CHALLENGE QUESTIONS

Ask the recommenders

4

CHECK FOR SALIENCY BIAS

Could the diagnosis be overly influenced by an analogy to a memorable success?

Ask for more analogies, and rigorously analyze their similarity to the current situation.

5

CHECK FOR CONFIRMATION BIAS

Are credible alternatives included along with the recommendation?

Request additional options.

6

CHECK FOR AVAILABILITY BIAS

If you had to make this decision again in a year's time, what information would you want, and can you get more of it now?

Use checklists of the data needed for each kind of decision.

7

CHECK FOR ANCHORING BIAS

Do you know where the numbers came from? Can there be
...unsubstantiated numbers?
...extrapolation from history?
...a motivation to use a certain anchor?

Reanchor with figures generated by other models or benchmarks, and request new analysis.

8

CHECK FOR HALO EFFECT

Is the team assuming that a person, organization, or approach that is successful in one area will be just as successful in another?

Eliminate false inferences, and ask the team to seek additional comparable examples.

In his review, Bob should encourage his sales colleagues to recognize the unknowns surrounding their proposal. The team may eventually admit that competitors' reactions to an across-the-board price cut are unpredictable. It should then be willing to evaluate other options, such as a targeted marketing program aimed at the customer segments in which Bob's company has a competitive advantage.

6. If you had to make this decision again in a year, what information would you want, and can you get more of it now? One challenge executives face when reviewing a recommendation is the WYSIATI assumption: What you see is all there is. Because our intuitive mind constructs a coherent narrative based on the evidence we have, making up for holes in it, we tend to overlook what is missing. Devesh, for instance, found the acquisition proposal compelling until he realized he had not seen a legal due diligence on the target company's patent portfolio—perhaps not a major issue if the acquisition were being made primarily to gain new customers but a critical question when the goal was to extend the product line.

To force yourself to examine the adequacy of the data, Harvard Business School professor Max Bazerman suggests asking the question above. In many cases, data are unavailable. But in some cases, useful information will be uncovered.

Checklists that specify what information is relevant to a certain type of decision are also helpful. Devesh, for his part, could tap his experience reviewing acquisition proposals and develop lists of data that should be collected for each different kind of deal his company does, such as acquiring new technology or buying access to new customers.

7. Do you know where the numbers came from? A focused examination of the key numbers underlying the proposal will help decision makers see through any anchoring bias. Questions to ask include: Which numbers in this plan are facts and which are estimates? Were these estimates developed by adjusting from another number? Who put the first number on the table?

Three different types of anchoring bias are common in business decisions. In the classic case, initial estimates, which are often best guesses, are used, and their accuracy is not challenged. The team making the proposal to Lisa, for instance, used a guesstimate on an important cost component of the capital investment project. More frequently, estimates are based on extrapolations from history, as they were when Devesh's team predicted the target company's sales by drawing a straight line. This, too, is a form of anchoring bias; one cannot always assume trends will continue. Finally, some anchors are clearly deliberate, such as when a buyer sets a low floor in a price negotiation. The trap of anchors is that people always believe they can disregard them, but in fact they cannot. Judges who are asked to



Lisa should have her team look at the proposed capacity improvement the way an incoming CEO might, asking: If I personally hadn't decided to build this plant in the first place, would I invest in expanding it?



CHECK FOR SUNK-COST FALLACY, ENDOWMENT EFFECT

Are the recommenders overly attached to a history of past decisions?

Consider the issue as if you were a new CEO.

roll a set of dice before making a (fortunately simulated) sentencing decision will of course deny that the dice influenced them, but analysis of their decisions shows that they did.

When a recommendation appears to be anchored by an initial reference and the number in question has a material impact, the decision maker should require the team behind the proposal to adjust its estimates after some reanchoring. If Lisa discovers that the investment budget she was asked to approve was derived from the costing of an earlier project, she can reanchor the team with a number she arrives at in a completely different way, such as a linear model based on investment projects carried out in other divisions, or competitive benchmarks. The aim is neither to arrive directly at a different number nor to slavishly "copy and paste" the practices of benchmarked competitors, but to force the team to consider its assumptions in another light.

8. Can you see a *halo effect*? This effect is at work when we see a story as simpler and more emotionally coherent than it really is. As Phil Rosenzweig shows in the book *The Halo Effect,* it causes us to attribute the successes and failures of firms to the personalities of their leaders. It may have led Devesh's team to link the success of the acquisition target to its senior management and assume that its recent outperformance would continue as long as those managers were still in place.

Companies deemed "excellent" are frequently circled by halos. Once an expert brands them in this way, people tend to assume that all their practices must be exemplary. In making its case for its capital investment, Lisa's team, for instance, pointed to a similar project undertaken by a highly admired company in another cyclical industry. According to the proposal, that company had "doubled down" on a moderately successful manufacturing investment, which paid off when the economy rebounded and the extra capacity was fully used.

Naturally, Lisa should ask whether the inference is justified. Does the team making the recommendation have specific information regarding the other company's decision, or is the team making assumptions based on the company's overall reputation? If the investment was indeed a success, how much of that success is attributable to chance events such as lucky timing? And is the situation of the other company truly similar to the situation of Lisa's company?

Such difficult questions are rarely asked, in part because it may seem off-base to take apart an outside comparison that is made in passing. Yet if Lisa simply tries to disregard the comparison, she will still be left with a vague, but hard to dispel, positive impression of the recommendation. A good and relatively simple practice is to first assess the relevance of the comparison ("What about this case is comparable with ours?") and then ask the people making it to propose other examples from less successful companies ("What other companies in our industry invested in a declining business, and how did it turn out for them?").

9. Are the people making the recommendation overly attached to past decisions? Companies do not start from scratch every day. Their history, and what they learn from it, matter. But history leads us astray when we evaluate options in reference to a past starting point instead of the future. The most visible consequence is the *sunk-cost fallacy*: When considering new investments, we should disregard past expenditures that don't affect future costs or revenues, but we don't. Note that Lisa's team was evaluating a capacity improvement in a product line that was struggling financially—partly because it was subscale, the team argued. Lisa should ask the team to look at this investment the way an incoming CEO might: If I personally hadn't decided to build the plant in the first place, would I invest in adding capacity?

Questions focused on evaluating the proposal

10. Is the base case overly optimistic? Most recommendations contain forecasts, which are notoriously prone to excessive optimism. One contributing factor is overconfidence, which could, say, lead Devesh's team to underestimate the challenge of integrating the acquired company and capturing synergies. Groups with a successful track record are more prone to this bias than others, so Devesh should be especially careful if the business development team has been on a winning streak.

Another factor frequently at work here is the *planning fallacy.* The planning fallacy arises from "inside view" thinking, which focuses exclusively on the case at hand and ignores the history of similar projects. This is like trying to divine the future of a company by considering only its plans and the obstacles it anticipates. An "outside view" of forecasting, in contrast, is statistical in nature and mainly uses the generalizable aspects of a broad set of problems to make predictions. Lisa should keep this in mind when reviewing her team's proposal. When drawing up a timeline for the completion of the proposed plant, did the team use a top-down (outside-view) comparison with similar projects, or did it estimate the time required for each step and add it up—a bottom-up (inside-view) approach that is likely to result in underestimates?

A third factor is the failure to anticipate how competitors will respond to a decision. For instance, in proposing price cuts, Bob's team did not account for the predictable reaction of the company's competitors: starting a price war.

All these biases are exacerbated in most organizations by the inevitable interplay (and frequent confusion) between forecasts and estimates on the one hand, and plans or targets on the other. Forecasts should be accurate, whereas targets should be ambitious. The two sets of numbers should not be confused by senior leadership.

Correcting for optimistic biases is difficult, and asking teams to revise their estimates will not suffice. The decision maker must take the lead by adopting an outside view, as opposed to the inside view of the people making proposals.

Several techniques help promote an outside view. Lisa could construct a list of several similar investment projects and ask her team to look at how long those projects took to complete, thus removing from the equation all inside information on the project at hand. Sometimes, removing what appears to be valuable information yields better estimates. In some situations decision makers might also put themselves in the shoes of their competitors. The use of "war games" is a powerful antidote to the lack of thinking about competitors' reactions to proposed moves.

11. Is the worst case bad enough? Many companies, when making important decisions, ask strategy teams to propose a range of scenarios, or at least



Improving Decisions Throughout the Organization

To critique recommendations effectively and in a sustainable way, you need to make quality control more than an individual effort.

Organizations pursue this objective in various ways, but good approaches have three principles in common. First, they adopt the right mind-set. The goal is not to create bureaucratic procedures or turn decision quality control into another element of "compliance" that can be delegated to a risk assessment unit. It's to stimulate discussion and debate. To accomplish this, organizations must tolerate and even encourage disagreements (as long as they are based on facts and not personal).

Second, they rotate the people in charge, rather than rely on one executive to be the quality policeman. Many companies, at least in theory, expect a functional leader such as a CFO or a chief strategy officer to play the role of challenger. But an insider whose primary job is to critique others loses political capital quickly. The use of a quality checklist may reduce this downside, as the challenger will be seen as "only playing by the rules," but high-quality debate is still unlikely.

Third, they inject a diversity of views and a mix of skills into the process. Some firms form ad hoc critique teams, asking outsiders or employees rotating in from other divisions to review plans. One company calls them "provocateurs" and makes playing this role a stage of leadership development. Another, as part of its strategic planning, systematically organizes critiques and brings in outside experts to do them. Both companies have explicitly thought about their decision processes, particularly those involving strategic plans, and invested effort in honing them. They have made their decision processes a source of competitive advantage.

a best and a worst case. Unfortunately, the worst case is rarely bad enough. A decision maker should ask: Where did the worst case come from? How sensitive is it to our competitors' responses? What could happen that we have not thought of?

The acquisition proposal Devesh is reviewing hinges on the target's sales forecast, and like most sales forecasts in due diligence reports, it follows a steep, straight, upward line. Devesh may ask his team to prepare a range of scenarios reflecting the merger's risks, but the team is likely to miss risks it has not experienced yet.

A useful technique in such situations is the "premortem," pioneered by psychologist Gary Klein. Participants project themselves into the future, imagine the worst has already happened, and make up a story about how it happened. Devesh's team could consider such scenarios as the departure of key executives who do not fit into the acquiring company's culture, technical problems with the target's key product lines, and insufficient resources for integration. It would then be able to consider whether to mitigate those risks or reassess the proposal.

12. Is the recommending team overly cautious? On the flip side, excessive conservatism is a source of less visible but serious chronic underperformance in organizations. Many executives complain that their teams' plans aren't creative or ambitious enough.

This issue is hard to address for two reasons. First and most important, the people making recommendations are subject to loss aversion: When they contemplate risky decisions, their wish to avoid losses is stronger than their desire for gains. No individual or team wants to be responsible for a failed project. Second, the fact that very few companies make explicit choices about what level of risk they will assume only exacerbates individual managers' loss aversion.

This helps explain why Lisa's colleagues had ruled out a new technology providing an alternative to the proposed investment: They deemed it too risky. To get her team to explore this option, she could provide assurances or (perhaps more credibly) explicitly share responsibility for the risk. When launching new ventures, many companies tackle this problem by creating separate organizational units with different objectives and budgets. But dealing with excessive conservatism in "ordinary" operations remains a challenge.

Implementing Quality Control Over Decisions

These 12 questions should be helpful to anyone who relies substantially on others' evaluations to make a final decision. But there's a time and place to ask them, and there are ways to make them part and parcel of your organization's decision-making processes.

When to use the checklist. This approach is not designed for routine decisions that an executive formally rubber-stamps. Lisa, the CFO, will want to use it for major capital expenditures but not her department's operating budget. The sweet spot for quality control is decisions that are both important and recurring, and so justify a formal process. Approving an R&D project, deciding on a large capital expenditure, and making a midsize acquisition of a company are all examples of "quality controllable" decisions.

Who should conduct the review. As we mentioned earlier, the very idea of quality control also assumes a real separation between the decision maker



Devesh should ask his M&A team to prepare a worst-case scenario that reflects the merger's risks, such as the departure of key executives, technical problems with the acquisition's products, and integration problems.



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Executives sometimes covertly influence teams' proposals, perhaps by choosing team members whose opinions are already known.

and the team making the recommendation. In many instances an executive will overtly or covertly influence a team's proposal, perhaps by picking team members whose opinions are already known, making his or her preferences clear in advance, or signaling opinions during the recommendation phase. If that is the case, the decision maker becomes a de facto member of the recommendation team and can no longer judge the quality of the proposal because his or her own biases have influenced it.

A clear and common sign that this has happened is overlap between the decision and action stages. If, at the time of a decision, steps have already been taken to implement it, the executive making the final call has probably communicated a preference for the outcome being recommended.

Enforcing discipline. Last, executives need to be prepared to be systematic—something that not all corporate cultures welcome. As Atul Gawande points out in *The Checklist Manifesto,* because each item on a checklist tends to seem sensible and unsurprising, it is tempting to use checklists partially and selectively. Doctors who adopted the World Health Organization's Surgical Safety Checklist knew that measures as simple as checking the patient's medication allergies made sense. But only by going through the checklist completely, systematically, and routinely did they achieve results—a spectacular reduction in complications and mortality. Using checklists is a matter of discipline, not genius. Partial adherence may be a recipe for total failure.

Costs and benefits. Is applying quality control to decisions a good investment of effort? Time-pressed executives do not want to delay action, and few corporations are prepared to devote special resources to a quality control exercise.

But in the end, Bob, Lisa, and Devesh all did, and averted serious problems as a result. Bob resisted the temptation to implement the price cut his team was clamoring for at the risk of destroying profitability and triggering a price war. Instead, he challenged the team to propose an alternative, and eventually successful, marketing plan. Lisa refused to approve an investment that, as she discovered, aimed to justify and prop up earlier sunk-cost investments in the same business. Her team later proposed an investment in a new technology that would leapfrog the competition. Finally, Devesh signed off on the deal his team was proposing, but not before additional due diligence had uncovered issues that led to a significant reduction in the acquisition price.

The real challenge for executives who want to implement decision quality control is not time or cost. It is the need to build awareness that even highly experienced, superbly competent, and well-intentioned managers are fallible. Organizations need to realize that a disciplined decision-making process, not individual genius, is the key to a sound strategy. And they will have to create a culture of open debate in which such processes can flourish.

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"Any recommendations besides your Nana?"

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Product Innovation

New-product development involves some art, some science—and some serendipity.



ARTWORK
Josef Schulz
Form #5
130 x 160



How P&G Tripled Its Innovation Success Rate

Inside the company's new-growth factory

by Bruce Brown and Scott D. Anthony

Bruce Brown is the chief technology officer of Procter & Gamble.

Scott D. Anthony is the managing director of Innosight.



BACK IN 2000 the prospects for Procter & Gamble's Tide, the biggest brand in the company's fabric and household care division, seemed limited. The laundry detergent had been around for more than 50 years and still dominated its core markets, but it was no longer growing fast enough to support P&G's needs. A decade later Tide's revenues have nearly doubled, helping push annual division revenues from $12 billion to almost $24 billion. The brand is surging in emerging markets, and its iconic bull's-eye logo is turning up on an array of new products and even new businesses, from instant clothes fresheners to neighborhood dry cleaners.

This isn't accidental. It's the result of a strategic effort by P&G over the past decade to systematize innovation and growth.

To understand P&G's strategy, we need to go back more than a century to the sources of its inspiration—Thomas Edison and Henry Ford. In the 1870s Edison created the world's first industrial research lab, Menlo Park, which gave rise to the technologies behind the modern electric-power and motion-picture industries. Under his inspired direction, the lab churned out ideas; Edison himself ultimately held more than 1,000 patents. Edison of course understood the importance of mass production, but it was his friend Henry Ford who, decades later, perfected it. In 1910 the Ford Motor Company shifted the production of its famous Model T from the Piquette Avenue Plant, in Detroit, to its new Highland Park complex nearby. Although the assembly line wasn't a novel concept, Highland Park showed what it was capable of: In four years Ford slashed the time required to build a car from more than 12 hours to just 93 minutes.

How could P&G marry the creativity of Edison's lab with the speed and reliability of Ford's factory? The answer its leaders devised, a "new-growth factory," is still ramping up. But already it has helped the company strengthen both its core businesses and its ability to capture innovative new-growth opportunities.

P&G's efforts to systematize the serendipity that so often sparks new-business creation carry important lessons for leaders faced with shrinking product life cycles and increasing global competition.

Laying the Foundation

Innovation has long been the backbone of P&G's growth. As chairman, president, and CEO Bob McDonald notes, "We know from our history that while promotions may win quarters, innovation wins decades." The company spends nearly $2 billion annually on R&D—roughly 50% more than its closest competitor, and more than most other competitors combined. Each year it invests at least another $400 million in foundational consumer research to discover opportunities for innovation, conducting some 20,000 studies involving more than 5 million consumers in nearly 100 countries. Odds are that as you're reading this, P&G researchers are in a store somewhere observing shoppers, or even in a consumer's home.

These investments are necessary but not sufficient to achieve P&G's innovation goals. "People will innovate for financial gain or for competitive advantage, but this can be self-limiting," McDonald says. "There needs to be an emotional component as well—a source of inspiration that motivates people." At P&G that inspiration lies in a sense of purpose driven from the top down—the message that each innovation improves people's lives.

At the start of the 2000s only about 15% of P&G's innovations were meeting revenue and profit targets. So the company launched its now well-known Connect + Develop program to bring in outside innovations and built a robust stage-gate process to help manage ideas from inception to launch. (For more on C+D, see Larry Huston and Nabil Sakkab, "Connect and Develop: Inside Procter & Gamble's New Model for Innovation," HBR March 2006.) These actions showed early signs of raising innovation success rates, but it was clear that

P&G needed more breakthrough innovations. And it had to come up with them as reliably as Ford's factory had rolled out Model Ts.

Idea in Brief

Procter & Gamble is a famous innovator. Nonetheless, in the early 2000s only 15% of its innovations were meeting their revenue and profit targets. To address this, the company set about building organizational structures to systematize innovation.

The resulting new-growth factory includes large new-business creation groups, focused project teams, and entrepreneurial guides who help teams rapidly prototype and test new products and business models in the market. The teams follow a step-by-step business development manual and use specialized project and portfolio management tools. Innovation and strategy assessments, once separate, are now combined in revamped executive reviews.

P&G's experience suggests six lessons for leaders looking to build new-growth factories: Coordinate the factory with the company's core businesses, be a vigilant portfolio manager, start small and grow carefully, create tools for gauging new businesses, make sure the right people are doing the right work, and nurture cross-pollination.

without a further boost to its organic growth capabilities, the company would still have trouble hitting its targets.

P&G's leaders recognized that the kind of growth the company was after couldn't come from simply doing more of the same. It needed to come up with more breakthrough innovations—ones that could create completely new markets. And it needed to do this as reliably as Henry Ford's Highland Park factory had rolled out Model Ts.

In 2004 Gil Cloyd, then the chief technology officer, and A.G. Lafley, then the CEO, tasked two 30-year P&G veterans, John Leikhim and David Goulait, with designing a new-growth factory whose intellectual underpinnings would derive from the Harvard Business School professor Clayton Christensen's disruptive-innovation theory. The basic concept of disruption—driving growth through new offerings that are simpler, more convenient, easier to access, or more affordable—was hardly foreign to P&G. Many of the company's powerhouse brands, including Tide, Crest, Pampers, and Swiffer, had followed disruptive paths.

Leikhim and Goulait, with support from other managers, began by holding a two-day workshop for seven new-product-development teams, guided by facilitators from Innosight (a firm Christensen cofounded). The attendees explored how to shake up embedded ways of thinking that can inhibit disruptive approaches. They formulated creative ways to address critical commercial questions—for example, whether demand would be sufficient to warrant a new-product launch. Learning from the workshop helped spur the development of new products, such as the probiotic supplement Align, and also bolstered existing ones, such as Pampers.

In the years that followed, Leikhim and Goulait shored up the factory's foundation, working with Cloyd and other P&G leaders to:

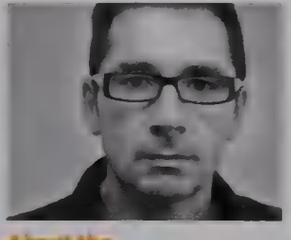
Teach senior management and project team members the mind-sets and behaviors that foster disruptive growth. The training, which has changed over time, initially ranged from short modules on topics such as assessing the demand for an early-stage idea to multiday courses in entrepreneurial thinking.

Form a group of new-growth-business guides to help teams working on disruptive projects. These experts might, for instance, advise teams to remain small until their project's key commercial questions, such as whether consumers would habitually use the new product, have been answered. The guides include several entrepreneurs who have succeeded—and, even more important, failed—in starting businesses.

Develop organizational structures to drive new growth. For example, in a handful of business units the company created small groups focused primarily on new-growth initiatives. The groups (which, like the training, have evolved significantly) augmented an existing entity, FutureWorks, whose charter is to create new brands and business models. Dedicated teams within the groups conducted market research, developed technology, created business plans, and tested assumptions for specific projects.

Produce a process manual—a step-by-step guide to creating new-growth businesses. The manual includes overarching principles as well as detailed procedures and templates to help teams describe opportunities, identify requirements for success, monitor progress, make go/no-go decisions, and more.

Run demonstration projects to showcase the emerging factory's work. One of these was a line of pocket-size products called Swash, which quickly refresh clothes: For example, someone who's in a hurry can give a not-quite-clean shirt a spray rather than putting it through the wash.



About the Spotlight Artist

Each month we illustrate our Spotlight package with a series of works from an accomplished artist. We hope that the lively and cerebral creations of these photographers, painters, and installation artists will infuse our pages with additional energy and intelligence and amplify what are often complex and abstract concepts.

This month's artist is **Josef Schulz**, a German photographer who often turns his lens on modern industrial constructs and digitally strips away defining details to render more-abstract, universally relevant images. "In the first step I'm a photographer with his limitations," he once told an interviewer, "and then an artist with his freedom of decisions."

View more of the artist's work at **josefschulz.de**.

P&G's Four Types of Innovation

Sustaining

Sustaining innovations bring incremental improvements to existing products: a little more cleaning power to a laundry detergent, a better flavor to a toothpaste. These provide what P&G calls "er" benefits—better, easier, cheaper—that are important to sustaining share among current customers and getting new people to try a product.

Commercial

Commercial innovations use creative marketing, packaging, and promotional approaches to grow existing offerings. During the 2010 Winter Olympics, P&G ran a series of ads celebrating mothers. The campaign covered 18 brands, was viewed repeatedly by hundreds of millions of consumers, and drove $100 million in revenues.

Sharpening the Focus

By 2008 P&G had a working prototype of the factory, but the company's innovation portfolio was weighed down by a proliferation of small projects. A.G. Lafley charged Bob McDonald (then the COO) and CTO Bruce Brown (a coauthor of this article) to dramatically increase innovation output by focusing the factory on fewer but bigger initiatives. McDonald and Brown's team drove three critical improvements.

First, rather than strictly separating innovations designed to bolster existing product lines from efforts to create new product lines or business models, P&G increased its emphasis on an intermediate category: *transformational-sustaining* innovations, which deliver major new benefits in existing product categories.

Consider the Crest brand, the market leader until the late 1990s, when it was usurped by Colgate. Looking for a comeback, in 2000 P&G launched a disruptive innovation, Crest Whitestrips, that made teeth whitening at home affordable and easy. In 2006 it introduced Crest Pro-Health, which squeezes half a dozen benefits into one tube—the toothpaste fights cavities, plaque, tartar, stains, gingivitis, and bad breath. In 2010 it rolled out Crest 3D White, a line of advanced oral care products, including one that whitens teeth in two hours. Such efforts helped Crest retake the lead in many markets. Pro-Health and 3D White were both transformational-sustaining innovations, meant to appeal to current consumers while attracting new ones. These sorts of innovations share an important trait with market-creating disruptive innovations: They have a high degree of uncertainty—something the factory is specifically designed to manage.

Second, P&G strengthened organizational supports for the formation of transformational-sustaining and disruptive businesses. It established several new-business-creation groups, larger in size and scope than any previous growth-factory team, whose resources and management are kept carefully separate from the core business. These groups—dedicated teams led by a general manager—develop ideas that cut across multiple businesses, and also pursue entirely new business opportunities. One group covers all of P&G's beauty and personal care businesses; another covers its household care business (the parent unit of the fabric-and-household and the family-and-baby-care divisions); a third, FutureWorks, focuses largely on enabling different business models (it helped guide P&G's recent partnership with the Indian business Healthpoint Services). The new groups supplement (rather than replace) existing supports such as the Corporate Innovation Fund, which provides seed capital to ideas that might otherwise slip through the cracks. P&G also created a specialized team called LearningWorks, which helps plan and execute in-market experiments to learn about purchase decisions and postpurchase use.

Third, P&G revamped its strategy development and review process. Innovation and strategy assessments had historically been handled separately. Now the CEO, CTO, and CFO explicitly link company, business, and innovation strategies. This integration, coupled with new analyses of such issues as competitive factors that could threaten a given business, has surfaced more opportunities for innovation. The process has also prompted examinations of each unit's "production schedule," or pipeline of growth opportunities, to ensure that it's robust enough to deliver against growth goals for the next seven to 10 years. Evaluations are made of individual business units (feminine care, for example) as well as broad sectors (household care). This revised approach calls for each business unit to determine the mix of innovation types it needs to deliver the required growth.

Transformational-Sustaining

Transformational-sustaining innovations reframe existing categories. They typically bring order-of-magnitude improvements and fundamental changes to a business and often lead to breakthroughs in market share, profit levels, and consumer acceptance. In 2009 P&G introduced the wrinkle-reducing cream Olay Pro-X. Launching a $40-a-bottle product in the depths of a recession might seem a questionable strategy. But P&G went ahead because it considered the product a transformational-sustaining innovation—clinically proven to be as effective as its much more expensive prescription counterparts, and superior to the company's other antiaging offerings. The cream and related products generated first-year sales of $50 million in U.S. food retailers and drugstores alone.

Disruptive

Disruptive innovations represent new-to-the-world business opportunities. A company enters entirely new businesses with radically new offerings, as P&G did with Swiffer and Febreze.

Running the Factory

Let's return now to Tide, whose dramatic growth highlights the potential of P&G's approach. Over the past decade the brand has launched numerous products and product-line extensions, carved new paths in emerging markets, and tested a promising new business model.

If you had looked for Tide in a U.S. supermarket 10 years ago, you would have found, for the most part, ordinary bottles and boxes of detergent. Now you'll see the Tide name on dozens of products, all with different scents and capabilities. For example, in 2009 P&G introduced a line of laundry additives called Tide Stain Release. Within a year, building on 26 patents, it incorporated these additives into a new detergent, Tide with Acti-Lift—the first major redesign of Tide's liquid laundry detergent in a decade. The product's launch drove immediate market-share growth of the Tide brand in the United States.

P&G has also customized formulations for emerging markets. Ethnographic research showed that about 80% of consumers in India wash their clothes by hand. They had to choose between detergents that were relatively gentle on the skin but not very good at actually cleaning clothes, and more-potent but harsher agents. With the problem clearly identified, in 2009 a team came up with Tide Naturals, which cleaned well without causing irritation. Mindful of the need in emerging markets to provide greater benefit at lower cost—"more for less"—P&G priced Tide Naturals 30% below comparably effective but harsher products. This made the Tide brand accessible to 70% of Indian consumers and has helped to significantly increase Tide's share in India.

More radically, Swash moved the Tide brand out of the laundry room. The line has clear disruptive characteristics: Swash products don't clean as thoroughly as laundry detergents or remove wrinkles as effectively as professional pressing. But because they're quick and easy to use, they offer "good enough" occasional alternatives between washes. Swash took an unconventional path to commercialization. When the products were first sold, in a store near P&G's headquarters in Ohio, they carried a different brand name and had no apparent connection to Tide. After that experiment, P&G opened a "pop up" Swash store at The Ohio State University. Both tests helped the company understand how consumers would buy and use the products, which P&G then began selling exclusively through Amazon and other online channels. In early 2011 the company ramped down its promotion of Swash, although learning from the effort will inform its work on other disruptive ideas in the clothes-refreshing space.

Tide Dry Cleaners is a factory innovation that represents an entirely new business model.

Whereas Swash was a new product line, Tide Dry Cleaners represents an entirely new business model. It started when a team began exploring ways to disrupt the dry-cleaning market, using proprietary technologies and a unique store design grounded in insights about consumers' frustrations with existing options. Many cleaning establishments are dingy, unfriendly places. Customers have to park, walk, and wait. Often the cleaners' hours are inconvenient. P&G's alternative: bright, boldly colored cleaners

The Factory's Consumer Research at Work

In October 2010 P&G launched the Gillette Guard razor in India, a transformational-sustaining innovation whose strategic intent was simple: to provide a cheaper and effective alternative for the hundreds of millions of Indians who use double-edged razors.

The company's researchers spent thousands of hours in the market to understand these consumers' needs. They gained important insights by observing men in rural areas who, lacking indoor plumbing, typically shave outdoors using little or no water—and don't shave every day. The single-blade Gillette Guard was thus designed to clean easily, with minimal water, and to manage longer stubble. The initial retail price was 15 rupees (33 cents), with refill cartridges for five rupees (11 cents). Early tests showed that consumers preferred the new product to double-edged razors by a six-to-one margin. Its breakthrough performance and affordability position it for rapid growth.

featuring specialized treatments, drive-through windows, and 24-hour storage lockers to facilitate after-hours drop-off and pickup.

Using the new-growth factory's process manual, the development team identified key assumptions about the proposed dry cleaners. For example, could the business model generate enough returns to attract store owners willing to pay up to $1 million for franchise rights? In 2009 P&G's guides helped the team open three pilots in Kansas City to try to find out. That year P&G also formed Agile Pursuits Franchising, a subsidiary to oversee such efforts, and transferred ownership of the dry-cleaning venture to FutureWorks, whose main mission is to pursue new business models that lie outside P&G's established systems. It remains to be seen how Tide Dry Cleaners will fare, but one promising sign came in 2010, when Andrew Cherng, the founder of the Panda Restaurant Group, announced plans to open 150 franchises in four years. He told *BusinessWeek*, "I wasn't around when McDonald's was taking franchisees, [but] I'm not going to miss this one."

To ensure strategic cohesion and smart resource allocation, Tide's innovation efforts have been closely coordinated through regular dialogues among several leaders—CEO McDonald, CTO Brown, the vice-chair of the household business unit, and the president of the fabric care division. They've also been the focus of discussions at Corporate Innovation Fund meetings and similar reviews.

This isn't just the methodical pursuit of a single innovation. It's part of a steady stream of ideas in development—a factory humming with work.

Lessons for Leaders

Efforts to build a new-growth factory in any company will fail unless senior managers create the right organizational structures, provide the proper resources, allow sufficient time for experimentation and learning, and personally engage. Our journey at P&G suggests six lessons for leaders looking to create new-growth factories.

1. Closely coordinate the factory and the core business. Leaders sometimes see efforts to foster new growth as completely distinct from efforts to bolster the core; indeed, many in the innovation community have argued as much for years. Our experience indicates the opposite. First, new-growth efforts depend on a healthy core business. A healthy core produces a cash flow that can be invested in new growth. And we've all known times when an ailing core has demanded management's full attention; a healthy core frees leaders to think about more-expansive growth initiatives.

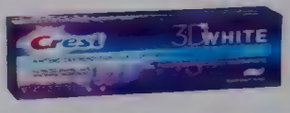
Second, a core business is rich with capabilities that can support new-growth efforts. Consider P&G's excellent relationships with major retailers. Those relationships are a powerful, hard-to-replicate asset that helps the factory expedite new-growth initiatives. Swiffer wouldn't be Swiffer without them.

Third, some of the tools for managing core efforts—particularly those that track a project's progress—are also useful for managing new-growth efforts. And finally, the factory's rapid-learning approach often yields insights that can strengthen existing product lines. One of the project teams at the 2004 workshop was seeking to spur conversion in emerging markets from cloth to disposable diapers. Subsequent in-market tests yielded a critical discovery: Babies who wore disposable diapers fell asleep 30% faster and slept 30 minutes longer than babies wearing cloth diapers—an obvious benefit for infants (and their parents). Advertising campaigns touting this advantage helped make Pampers the number one brand in several emerging markets.

2. Promote a portfolio mind-set. P&G communicates to both internal and external stakeholders that it is building a varied portfolio of innovation



GILLETTE GUARD
After thousands of hours of research in the field, P&G learned that a single-blade razor was a cheaper and effective alternative to double-edged razors for many consumers in India.



CREST 3D WHITE
Usurped by Colgate in the late 1990s, Crest has regained the lead in many markets owing to its introduction of several innovative oral care products, including ones that make teeth whitening at home affordable and easy.

approaches, ranging from sustaining to disruptive ones. (See the sidebar "P&G's Four Types of Innovation.") It uses a set of master-planning tools to match the pace of innovation to the overall needs of the business. It also deploys portfolio-optimization tools that help managers identify and kill the least-promising programs and nurture the best bets. These tools create projections for every active idea, including estimates of the financial potential and the human and capital investments that will be required. Some ideas are evaluated with classic net-present-value calculations, others with a risk-adjusted real-option approach, and still others with more-qualitative criteria. Although the tools assemble a rank-ordered list of projects, P&G's portfolio management isn't, at its core, a mechanical exercise; it's a dialogue about resource allocation and business-growth building blocks. Numerical input informs but doesn't dictate decisions.

A portfolio approach has several benefits. First, it sets up the expectation that different projects will be managed, resourced, and measured in different ways, just as an investor would use different criteria to evaluate an equity investment and a real estate one. Second, because the portfolio consists largely of sustaining and transformational-sustaining efforts, seeing it as a whole highlights the critical importance of these activities, which protect and extend core businesses. Finally, a portfolio approach helps reinforce the message that any project, particularly a disruptive one, may carry substantial risk and might not deliver commercial results—and that's fine, as long as the portfolio accounts for the risk.

3. Start small and grow carefully. Remember how the new-growth factory began: with a simple two-day workshop. It then expanded to small-scale pilots in several business units before becoming a companywide initiative.

Staged investment allows for early, rapid revision—before lines scribbled on a hypothetical organizational chart are engraved in stone. It also provides for targeted experimentation. For example, there is legitimate disagreement about the best way to organize for new growth. Whereas we believe in a factory with relatively strong ties to the core, some advocate a "skunkworks" organization. Others argue for "distinct but linked" organizations under an "ambidextrous" leader; still others recommend mirroring the structure of a venture capital firm. (P&G's factory uses several organizational approaches.) Treating capability development itself as a new-growth innovation lets companies try different approaches and learn what works best for them.

A staged approach serves another important purpose: It's a built-in reminder that a new-growth factory is not a quick fix. The factory won't provide a sudden boost to next quarter's results, nor can it instantly rein in an out-of-control core business that's veering from crisis to crisis.

4. Create new tools for gauging new businesses. Anticipated and nascent markets are notoriously hard to analyze. Detailed follow-up with one of the project teams that attended the pilot workshop showed P&G that it needed new tools for this purpose. P&G now conducts "transaction learning experiments," or TLEs, in which a team "makes a little and sells a little," thus letting consumers vote with their wallets. Teams have sold small amounts of products online, at mall kiosks, in pop-up stores, and at amusement parks—even in the company store and outside company cafeterias. P&G devised a venture capital approach to testing the market for Align, its probiotic supplement, providing seed capital for a controlled pilot. The company has also tested entire business models—recall the Kansas City pilots of Tide Dry Cleaners.

P&G now conducts "transaction learning experiments," which let consumers vote with their wallets.

5. Make sure you have the right people doing the right work. Building the factory forced P&G to change the way it staffed certain teams. At any given time the company has hundreds of teams working on various innovation efforts. In the past, most teams consisted mainly of part-time members—employees who had other responsibilities pulling at them. But disruptive and transformational-sustaining efforts

CONNECT WITH THE AUTHORS Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.



TIDE DRY CLEANERS
Still in an early stage, this innovation arose in part from insights about consumers' frustrations with the dinginess and inconvenience of most existing dry-cleaning establishments.

require undivided attention. (As the old saying goes, nine women can't make a baby in a month.) There need to be people who wake up each day and go to sleep each night obsessing about the new business.

New-growth teams also need to be small and nimble, and they should include seasoned members. P&G found that big teams often bog down because they pursue too many ideas at once, whereas small teams are better able to quickly focus on the most-promising initiatives. Having several members with substantial innovation experience helps teams confidently make sound judgment calls when data are inconclusive or absent.

Finally, building a factory requires a substantial investment in widespread, ongoing training. Changing mind-sets begins, literally, with teaching a new language. Key terms such as "disruptive innovation," "job to be done," "business model," and "critical assumptions" must be clearly and consistently defined. P&G reinforces key innovation concepts both at large meetings and at smaller, focused workshops, and in 2007 it established a "disruptive innovation college." People working on new-growth projects can choose from more than a dozen courses, ranging from basic innovation language to designing and executing a TLE, sketching out a business model, staffing a new-growth team, and identifying a job to be done.

6. Encourage intersections. Successful innovation requires rich cross-pollination both inside and outside the organization. P&G's Connect + Develop program is part of a larger effort to intersect with other disciplines and gain new perspectives. Over the past few years P&G has:

▪ *Shared people with noncompeting companies.* In 2008 P&G and Google swapped two dozen employees for a few weeks. P&G wanted greater exposure to online models; Google was interested in learning more about how to build brands.

• *Engaged even more outside innovators.* In 2010 P&G refreshed its C+D goals. It aims to become the partner of choice for innovation collaboration, and to triple C+D's contribution to P&G's innovation development (which would mean deriving $3 billion of the company's annual sales growth from outside innovators). It has expanded the program to forge additional connections with government labs, universities, small and medium-sized entrepreneurs, consortia, and venture capital firms.

▪ *Brought in outside talent.* P&G has traditionally promoted from within. But it recognized that total reliance on this approach could stunt its ability to create new-growth businesses. So it began bringing in high-level people to address needs beyond its core capabilities, as when it hired an outsider to run Agile Pursuits Franchising. In that one stroke, it acquired expertise in franchise-based business models that would have taken years to build organically.

SOME THINK it's foolish for large companies to even attempt to create innovative-growth businesses. They maintain that organizations should just outsource innovation, by acquiring promising start-ups.

But P&G's efforts appear to be working. Recall that in 2000 only 15% of its innovation efforts met profit and revenue targets. Today the figure is 50%. The past fiscal year was one of the most productive innovation years in the company's history, and the company's three- and five-year innovation portfolios are sufficient to deliver against their growth objectives. Projections suggest that the typical initiative in 2014 and 2015 will have nearly twice the revenue of today's initiatives. That's a sixfold increase in output without any significant increase in inputs.

Our experience tells us that although individual creativity can be unpredictable and uncontrollable, collective creativity can be managed. Although the next Tide or Crest innovation might stumble, the factory's methodical approach should bring many more innovations successfully to market. The factory process can create sustainable sources of revenue growth—no matter how big a company becomes.

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At P&G's "disruptive innovation college," people working on new-growth projects can choose from more than a dozen courses.



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*Source: Over the 10-year period ending October 2010, gold's correlation with the S&P 500 has been -0.06, with 0 being uncorrelated and 1 being perfectly correlated (StyleADVISOR, December 2010).

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C-print, 120 x 270 cm

The Ambidextrous CEO

Great leaders navigate the tension between new innovations and core products from the C-suite—they don't leave the battle to their middle managers.

by Michael L. Tushman, Wendy K. Smith, and Andy Binns



THE FALL OF 2008, Mike Lawrie, the CEO of the London-based software firm Misys, asked his senior executives to prepare a plan for weathering the global economic crisis. When they reported back, at the top of their list of recommendations was to cut the company's annual $3 million investment in Misys Open Source Solutions, a venture aimed at developing a potentially disruptive technology in the health care industry.

It's a familiar story. Although most executives acknowledge the need to explore new businesses and markets, they almost always bow to the more-pressing claims of the core business, especially when times are hard. Innovations like Misys's Open Source face an uphill battle to secure a share of the firm's capital. They lack scale and resources and are usually underrepresented at the top table. At best, the leaders of the established business units ignore such projects. At worst, they see them as threats to the firm's core identity and values.

Often, innovation's only friend is the CEO. Even so, many CEOs view the competing demands of the core businesses and the new units as a set of trade-offs to be made. They often end up trying to persuade the heads of the core businesses to support and fund the innovations housed in their units on which the company's long-term future depends. In other words, the CEO pushes the key decisions about the right balance between investment in new and

core businesses down into the units, ceding much of his or her own power and creating a collection of feudal baronies.

This is a recipe for failure. Our research suggests that firms thrive when senior teams embrace the tension between old and new and foster a state of constant creative conflict at the top. We call this *leading ambidextrously.* We conducted an in-depth study of 12 top-management teams at major companies and identified three leadership principles that help firms grow their core businesses even as they cultivate new offerings that will reshape their industries: (1) Engage the senior team around a forward-looking strategic aspiration. (2) Explicitly hold the tension between the demands of innovation units and the core business at the top of the organization. (3) Embrace inconsistency by maintaining multiple and often conflicting strategic agendas.

When leaders take this approach, they empower their senior teams to move from a negotiation of feudal interests to an explicit, ongoing, and forward-looking debate about the tensions at the heart of the business. Before we look at the principles in depth, let's begin with a case study.

Open Source: The New Shark in the Water

When Mike Lawrie came to Misys, in 2006, he recruited a new management team to turn around the struggling software firm. The company, which served the financial services and health care industries, had been plagued by problems with quality, and it was losing customers at an alarming rate.

Despite the pressure to shore up the existing business, one of Lawrie's first moves was to create a stand-alone unit for open source technology, which was a key component of his vision for the company's future. He knew that open source was emerging as a serious disruptive threat in the software industry, especially in health care. It held the promise of seamless data exchange between the many players in health care delivery. Lawrie believed that Misys had an opportunity to get out in front and be the disruptor.

After securing the investment in Open Source, Lawrie and his team turned to more-immediate concerns of the core business. By 2007, they had stemmed the tide of customer defections and restored the health care business to profitability. In 2008, laying plans to weather the crisis, Lawrie put the business back into growth mode with the acquisition of Allscripts, a major proprietary electronic health records (EHR) provider. And just as Misys catapulted into an industry-leading position, the U.S. government began to inject $19.2 billion of stimulus money into upgrading IT systems for doctors and hospitals nationwide.

The postcrash outlook was a lot less rosy for the financial services sector, however. Lawrie's team needed to generate significant cost savings if they were to both keep financial services going and fund their plans for the Allscripts health care unit.

Against this background, Open Source seemed to be more trouble than it was worth. The leaders of the core units advised Lawrie to unlock capital by selling off the investment. "Cut it now," one executive told him. "You can't afford the distraction."

But Lawrie did more than just protect the investment. At the height of the financial crisis, he gave it an even stronger organizational voice: Open Source was the only Misys health care asset not folded into the core Allscripts unit. This permitted Open Source leaders to sit at the table with Allscripts top executives and compete for resources. Every strategic move involved trade-offs between more-immediate returns from Allscripts and longer-term returns from Open Source. The tensions reflected the power struggle over the firm's identity and future. For example, the head of Allscripts wanted his proprietary software to dominate, and he saw Open Source as a direct threat. His fears proved well-founded; Open Source soon started to beat out Allscripts for contracts.

Firms thrive when senior teams embrace the tension between old and new and foster a state of constant creative conflict at the top.

Idea in Brief

Balancing the needs of core businesses and innovation efforts is a central leadership task.

Unfortunately, most CEOs cede that responsibility to core-business heads, because innovation efforts are typically embedded in their units. The result is that competition for resources and attention usually gets resolved in favor of the established business.

On the basis of an in-depth study of 12 top-management teams at major companies, the authors suggest that CEOs take a very different approach. Specifically, they should:

- engage the senior team around a forward-looking strategic aspiration,
- hold the tension between the demands of innovation units and the core business at the top of the organization, and
- maintain multiple and often conflicting strategic agendas.

When leaders take this approach, they empower their senior teams to move from a negotiation of feudal interests to an explicit, ongoing debate about the conflicting interests on which the future of the business depends.

Lawrie wisely held this tension in his senior team, and his strategy has paid dividends. Allscripts revenues grew more than 30% in 2009, even as Misys Open Source won important contracts. The software is opening up the potential for integrated data sharing among hospitals, physicians, and insurers and could radically improve the U.S. health care system's ability to manage costs and patient outcomes. In addition, Open Source has triggered innovation in other Misys units: A new banking product was developed using open source components, and Misys's website is completely open source.

The firm's business unit leaders now recognize that Open Source is not the irritating drain on resources they had envisioned but a vital experiment aimed at securing Misys's long-term future. In fact, in June 2009 Bob Barthelmes, the executive Lawrie recruited to head the Open Source unit, received an unlikely gift from the other unit heads at the top team's annual offsite: an inflatable shark, symbolizing their acceptance of Open Source's right to swim with the sharks.

Let's look at the leadership principles that enabled Misys's success.

PRINCIPLE 1

Develop an Overarching Identity

The importance of properly framing your organization's identity is well known. In his seminal 1960 HBR article, "Marketing Myopia," Ted Levitt argued that the U.S. railway companies failed to survive the rise of the motor car and the passenger jet in large part because they defined themselves too narrowly—by the assets they had built up rather than by what they did with those assets. They saw themselves as railway companies rather than transportation companies. It's the kind of mistake companies still make.

Companies that develop overarching identities avoid this mistake. A broader identity gives units permission to engage in opposing strategies—to exploit existing products and services while simultaneously exploring new offerings and business models. In just this way, the Ball Company has been able to successfully reinvent itself over more than 100 years. Its evolution from wooden buckets to glass jars to metal cans to plastic bottles was in part rooted in the firm's overarching aspiration to be the "world's best container company."

Mike Lawrie created just such an overarching identity at Misys. The firm had grown by acquiring software assets and building a large customer base for its proprietary products. Lawrie refocused the company on its customers' mission-critical problems and embraced open source technology as a new way to help customers solve them. As the company's executives began to think of their firm as one that solved industrywide problems rather than as a vendor of software applications, new areas of innovation emerged. The banking unit, for instance, developed a product that enables retail banks to bring offerings to market faster, by challenging some of the software industry's standard approaches.

At LexisNexis's Martindale-Hubbell division, CEO Phil Livingston faced a similar tension between current and future demands. He transformed his business unit by broadening its identity from a publisher of legal directories to a web-based marketing business for lawyers. His integrative aspiration to create leads for lawyers opened up a range of new marketing-related services for law firms that has made his unit the fastest-growing one in the LexisNexis portfolio.

PRINCIPLE 2

Hold Tension at the Top

In many companies, innovation units are embedded in the core businesses, and negotiations for capital and resources take place under the radar of

PRINCIPLE 1

Are you developing an overarching identity? Here's what to ask:

IDENTITY

Does your firm have an emotionally compelling identity that encompasses your existing products and services?

Is your identity broad enough to be aspirational?

Does your identity limit you to customer groups or solutions that may be disrupted in the future?

When conflicts about funding old and new businesses are resolved at lower levels, innovation usually loses out.

PRINCIPLE 2

Are you holding tension at the top? Here's what to ask:

REPORTING LINES
Do innovation business units report directly to the CEO? If not, you may be allowing your current business to starve innovation at lower levels in the organization.

OWNERSHIP
Does someone at the top own innovation? If the answer is "everyone owns it," the reality is probably that no one does. In such cases, the needs of established businesses will almost always trump those of speculative units.

LOCUS OF DEBATE
Are the fiercest strategy battles being fought among top executives? Pushing the conflict down to lower levels often means that important decisions about the company's future will devolve into turf battles.

COORDINATION
Do you know what the innovation units need from the core business to be successful?

the top team. This was the case at Hewlett-Packard, which by 1996 had built a successful franchise in the fast-growing market for flatbed scanners. As the business was rapidly scaling to meet demand, a new innovation emerged: the portable handheld scanner.

A small team, several layers down within the scanners unit, developed a portables prototype. They believed the innovation would revolutionize the market, but they couldn't get attention from managers whose focus was winning market share for the flatbed. Then senior HP executive Antonio Perez intervened with $10 million of funding to validate the portables business, but within months the scanners unit had diverted the funds to plug a hole in its budget. The portables R&D team was left with no funds and no authority.

Pushing the conflict down to lower levels is a common pathology. It shields the top leadership team from the pain of making tough choices about how to fund innovation while maintaining the core business. Typically, nobody on the senior team carries the responsibility for innovating. Senior management time is dominated by operational problem-solving, with only occasional flashes of interest in the future. The tension gets resolved at lower levels, and innovation usually loses out. As we saw at HP, the new units starve or are suffocated by the core business.

Another result of pushing innovation down into the business unit is a lack of coordination among initiatives. In 2002, BT was a collection of powerful telephony-focused business units, nominally held together by a 25-person management committee. Innovation efforts were housed within the units, which meant that debate around emerging trends was ceded to lower-level management. Owing to this senior-team abdication, BT launched two competing broadband products, both of which were underfunded. As a consequence, only 40% of the UK population had service—well below aspirations.

Our research shows that decisions about the firm's present and future must be made at the senior-executive level. We've identified two equally successful but vastly different approaches to holding tension at the top.

Hub and spoke. The first approach we call hub and spoke: The CEO (or general manager) sits at the center of a wheel surrounded by business unit leaders, each of whom confers and communicates only with the CEO, not with one another. The CEO manages each spoke of the wheel separately, and each business unit relies heavily on the leader. Analog Devices has thrived for more than 40 years using this method of management. Each time the organization developed a new stream of revenue, it created a new unit with its own leaders, engineers, and local culture. Cofounder Ray Stata took personal responsibility for the integration across these revenue streams so that his other leaders could focus on their own products. That didn't mean that Stata made decisions alone. Key to his model was a COO who shared responsibility for the integration; Stata even had a soundproof room built off his office for their fighting matches.

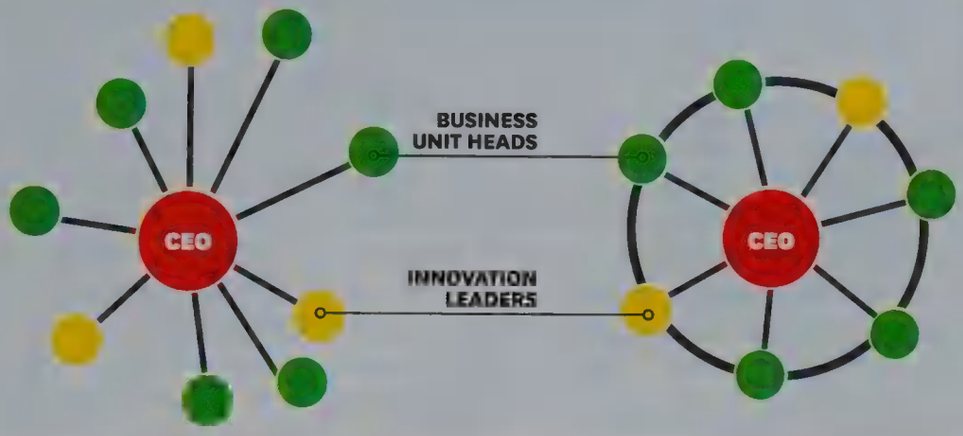
Many hub-and-spoke teams manage through an inner circle of two or three individuals. Unit leaders interact extensively with the inner circle to learn, advocate, and report progress, but they rarely deal with other unit leaders. Cross-team meetings serve primarily as informational updates. Resolution between exploitative and exploratory strategies takes place in the senior leader's office.

Ring-team model. In stark contrast to the hub-and-spoke approach, a ring-team model brings unit leaders together in the CEO's key circle. Decisions are made collectively by the senior team about how to allocate resources and make trade-offs between the present and the future.

Pete Ungaro, CEO of Cray, adopted this approach when he was brought in to lead a turnaround at the legendary supercomputer firm. Cray defined the first era of the IT industry, but its fortunes sank as the market commoditized. Ungaro's strategy was to redefine the firm as a seller of technology solutions, leveraging its engineering excellence, not just its

How to Hold Tension at the Top: Two Approaches

HUB-AND-SPOKE TEAM members each have a mission to optimize their units in the service of a shared strategic intent. The CEO, with an inner circle of advisers, negotiates tension among units, insulating innovation from short-term pressures and making trade-offs across the business.



RING TEAMS own innovation as a strategic responsibility and make dynamic trade-offs as a collective unit. Team meetings focus on contentious, high-stakes issues and find resolutions that serve the overall needs of the business over the short and long term.

computer hardware. To that end, he unveiled a new unit called Custom Engineering. However, he knew the sales team would be a major barrier to scaling the business. The team was well-drilled in selling supercomputers, but not in the art of solution sales. Ungaro laid out the dilemma to the unit heads and together they decided "to bite the bullet to create a separate business unit organization," Ungaro told us. "That was a pretty big decision for us," he added. The top team knew this would hurt short-term financial performance, but they recognized and supported the investment in the future.

In most ring teams, the business unit leaders are compensated on the basis of total company performance—not individual P&Ls—and there is a clear focus on the long-term drivers of growth. Because team members make decisions as a group, higher degrees of collaboration are required. Extensive communication is a must, as is a leader who is able to deal with the complex dynamics associated with juggling contrasting time frames.

Ring team members share an obligation to debate and express dissent over critical issues. They are expected to identify problems and call one another out in a transparent manner. Ben Verwaayen, formerly of BT, told us that shortly after he joined the firm as CEO, he challenged an executive who had come to present to the top team. "When I pressed him, he admitted that he didn't agree with anything that he'd just said and that he was just presenting what he was told to present," he said. Verwaayen promptly informed the team members that if they couldn't talk frankly about the business, he was not interested in listening to them. This is a classic ring-team approach—get the issues on the table and hammer them out. The goal is not to reach a compromise, but rather to discover together the best way to advance the company's agenda in both the short and longer term.

Giving the innovation units such a powerful voice in the senior team and such a substantial claim on time and resources is stressful. As Cray Computer's Pete Ungaro told us, "We had to convince ourselves that spending 50% of our time on something that is delivering 5% of the company's revenues was worth the effort." Nonetheless, the results speak for themselves. Once near death, Cray has fought back to profitability, and in 2010, revenues grew by more than 6%.

PRINCIPLE 3

Embrace Inconsistency

In many companies, innovation units find themselves measured against the performance standards of the core business. This puts the innovation unit at a disadvantage as it struggles to match up to a well-established business that has proven itself.

The successful top teams we studied did not fall into this trap. They held core and innovation units to different standards, demanding profit and discipline for some and encouraging experimentation in others. They look at each unit on its own merits so that they can focus on what's important for a business at its particular point in its growth cycle.

Take former *USA Today* president Tom Curley, who grew his company's online business even as he scaled the newspaper into a publishing phenomenon. Curley's expectations for everything from financial performance to dress code were markedly different for the two channels. In the newspaper, deadlines were daily, and professional journalists relied on their well-tended sources to break fresh content. In the online business, 600 deadlines a day were met by a young, web-savvy team who packaged wire service content. Curley created two fundamentally contrasting units, kept them physically and culturally distinct, and each reported directly to him.

PRINCIPLE 3

Are you embracing inconsistency? Here's what to ask:

MANAGEMENT SYSTEM
Are your innovation businesses measured and rewarded against the same metrics as established ones? If so, you are probably setting those units up for failure.

DECISION MAKING
Are you continually shifting resources (financial investments, talent) between core businesses and innovation units? If not, you may be limiting the value your resources offer your firm.

When a CEO embraces inconsistency in this way, the company's mission and strategy can seem incoherent, with different parts of the business focusing on sometimes conflicting time horizons and metrics. A CEO and his team might support a given strategy in one part of the business yet seek to cannibalize it in another. For example, Analog's Ray Stata continued to build out and invest in a fab for manufacturing analog chips even as he was aggressively investing in research for digital chips. At Cray, Pete Ungaro managed the core business tightly on revenues and profit, but "we would celebrate if somebody went for a cup of coffee with their partner in an exploratory business," he recalls.

Similarly, at Zensar Technologies, a midsize Indian IT services firm, CEO Ganesh Natarajan built a distinct business unit, reporting directly to him, for a potentially disruptive software solution when he saw that the firm's product-oriented general managers were ignoring the innovation. In 2005, Natarajan pushed his senior team to attend to the tensions between their known technologies and this new platform. Today, much of Zensar's growth is rooted in the new solutions platform.



"I hear they call you the hard copy guy."

Supporting core businesses and innovation units requires leaders to be consistently inconsistent. They must live with a dual agenda. The approach runs counter to conventional thinking on leadership, but we believe that too much consistency in a company's strategy is a danger sign, indicating that the company has run out of ideas or is relegating innovation to lower levels.

It's not always possible to give both innovation and core units everything they need—resources are scarce. Successful top teams, therefore, move resources between businesses as shifting needs demand. They may tilt capital investments in favor of the core business at one moment, and soon after may ring-fence funds for the innovation unit. Top talent also moves flexibly between the units to make sure that the best people are placed where they're needed most. For example, in IBM's software group, general manager Janet Perna created sales SWAT teams to sell a new content-management system. Perna saw this as a way to focus resources on launching the new product for a short time, before pulling them back into an integrated sales team.

IN LATE 2010 Curley's successor at *USA Today*, David Hunke, announced that the paper was shifting all operations to the web, shedding 10% of the print workforce in the process. The firm was also planning to launch a new, all-digital, *USA Today Sports* offering, focused on winning share in the tablet and mobile phone news market. As once-great newspapers like the *Washington Post* struggle for survival, *USA Today* has positioned itself for reinvention. It could do this because Curley embraced inconsistency and tension at the top levels of the company.

When leaders take an ambidextrous approach, they force their senior teams to abandon feudal battles and engage in forward-looking debate about the tensions at the heart of the business. Their capacity for taking advantage of the opposing objectives, needs, and constraints of core businesses and innovation units enables them to deliver extraordinary performance, time and again.

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Spotlight

Roger L. Martin is dean of the University of Toronto's Rotman School of Management and the author of *The Design of Business* (Harvard Business Review Press, 2009) and *Fixing the Game* (Harvard Business Review Press, 2011).

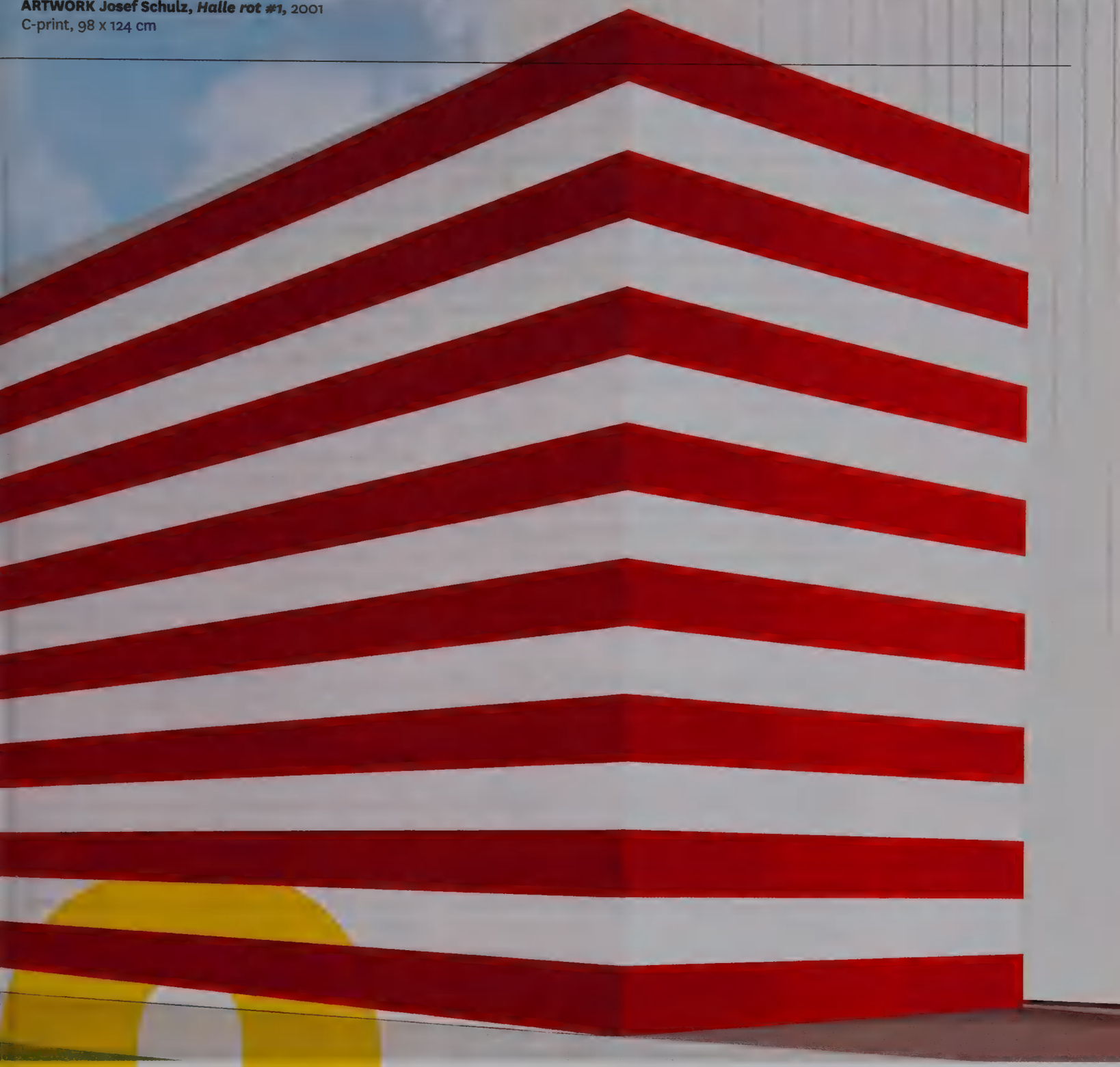


The Innovation Catalysts

The best creative thinking happens on a company's front lines. You just need to encourage it.

by Roger L. Martin

ARTWORK Josef Schulz, *Halle rot #1,* 2001
C-print, 98 x 124 cm



ONE DAY in 2007, midway through a five-hour PowerPoint presentation, Scott Cook realized that he wasn't another Steve Jobs. At first it was a bitter disappointment. Like many entrepreneurs, Cook wanted the company he had cofounded to be like Apple—design driven, innovation intensive, wowing consumers year in and year out with fantastic offerings. But that kind of success always seemed to need a powerful visionary at the top.

This article is about how Cook and his colleagues at the software development company Intuit found an alternative to the Steve Jobs model: one that has enabled Intuit to become a design-driven innovation machine. Any corporation—no matter how small or prosaic its business—can make the same grassroots transformation if it really wants to.

The Birth of the Idea

Intuit's transformation arguably began in 2004, with its adoption of the famous Net Promoter Score. Developed by Fred Reichheld, of Bain & Company, NPS depends on one simple question for customers: How likely are you, on a scale of 0 (not at all likely) to 10 (extremely likely), to recommend this product or service to a colleague or friend? "Detractors" answer from 0 to 6, "passives" answer 7 or 8, and "promot-



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ers" answer 9 or 10. A company's Net Promoter Score is the percentage of promoters less the percentage of detractors.

For the first couple of years, Intuit saw its NPS rise significantly, owing to a number of marketing initiatives. But by 2007 NPS growth had stalled. It was not hard to see why. Although Intuit had lowered its detractor percentage substantially, it had made little headway with promoters. Customer recommendations of new products were especially disappointing.

Clearly, Intuit needed to figure out how to galvanize its customers. Cook, a member of Procter & Gamble's board of directors, approached Claudia Kotchka, then P&G's vice president of design innovation and strategy, for advice. Following their discussions, Cook and Steve Bennett, then Intuit's CEO, decided to focus on the role of design in innovation at a two-day off-site for the company's top 300 managers. Cook created a one-day program on what he called Design for Delight (D4D)—an event aimed at launching Intuit's reinvention as a design-driven company.

The centerpiece of the day was that five-hour PowerPoint presentation, in which Cook laid out the wonders of design and how it could entice Intuit's customers. The managers listened dutifully and clapped appreciatively at the end, as they were supposed to; Cook was, after all, a company founder. Nevertheless, he was disappointed by his reception. Despite some interest in the ideas presented, there was little energy in the room.

But although the main event fell flat, the one that followed did not. Cook had met a young consulting associate professor at Stanford named Alex Kazaks, whom he'd invited to present for an hour at the off-site. Like Cook, Kazaks began with a PowerPoint presentation, but he ended his after 10 minutes and used the rest of the time for a participatory exercise: The managers worked through a design challenge, creating prototypes, getting feedback, iterating, and refining.

The group was mesmerized. Afterward Cook informally polled the participants, asking what takeaways they'd gotten from the daylong session. Two-thirds of the lessons they reported came from the hands-on exercise. This reaction made Cook think: He might not be the next Steve Jobs, but perhaps his company didn't need one. Given a few tools, coaching, and practice, could the grass roots of the company drive success in innovation and customer delight?

From Idea to Initiative

Like most Silicon Valley tech companies, Intuit had user-interface designers, graphic designers, and others buried relatively deep in the organization. Cook turned to a particularly talented young design director, Kaaren Hanson, and asked her what she would do to promote design at Intuit.

Hanson realized that the company needed an organized program for moving from talking about D4D to doing it. She persuaded Cook to let her create a team of design-thinking coaches—"innovation catalysts"—who could help Intuit managers work on initiatives throughout the organization. Hanson selected nine colleagues to join her in this role. Their training and deployment was her central agenda for FY 2009.

In selecting the nine, Hanson looked first for people with a broad perspective on what it meant to be a designer: Beyond creating a graphic user interface that was both appealing and intuitive, it included thinking about whether the software solved the user's problem in a delightful way. She wanted her coaches to be interested in talking to users and solving problems with colleagues rather than depending solely on their own genius. If they were to successfully coach others in design thinking, they'd need an outgoing personality and good people skills.

She invited two direct reports from her own business unit and seven people from other units across the company. The group included six women and four men. They came from a variety of fields within

> In one year, 32 ideas generated by an in-house social network called Brainstorm made it to market.

Idea in Brief

Many entrepreneurs want their start-ups to be like Apple—design driven, innovation intensive, wowing consumers with fantastic offerings. Unfortunately, that kind of success always seems to require a powerful visionary at the top, which few companies have.

Scott Cook, a cofounder of Intuit, realized that innovative design could be generated from the ranks if the frontline troops were empowered to develop their own ideas. Intuit created a team of 10 "innovation catalysts" to help managers throughout the organization work on design initiatives.

In a process known as Design for Delight, managers identify customer pain points through direct field research, brainstorm about how to reduce them, and swiftly prototype solutions. The impact on Intuit has been huge: Net Promoter Scores, revenue, and income have increased substantially over the past three years.

Intuit—design, research, product management—and had titles such as user-interface architect, principal researcher, staff designer, and product manager. Hanson chose people who were influential even though they were all one or two levels below director, meaning closer to the bottom of the organization than the top. All nine signed up enthusiastically.

To begin building design thinking into the DNA of the company, Cook and Hanson organized a series of Design for Delight forums. These were typically attended by more than 1,000 employees and featured a speaker who'd had exemplary success in creating customer delight. Half the featured speakers came from inside Intuit; the other half included the founding CEO of Flip Video, Facebook's top data scientist, and the head of Apple Stores. The forums also showcased D4D successes to date and shared best practices. People who worked together were encouraged to attend together and were asked as a team to identify the one thing they would do differently after the forum.

To ensure that managers who were thinking design didn't become too intimidated to begin the process, or frustrated trying to do something with which they had little experience, or delayed by needing to hire an outside design consultant, Hanson's innovation catalysts were available to help any work group create prototypes, run experiments, and learn from customers. Of course, there was a risk that this would stretch the catalysts too thin, so Hanson placed some constraints on their availability. They were expected to spend 25% of their time on big-payoff projects for Intuit overall. Hanson kept in close contact with general managers who had catalysts working with them to make sure that the catalysts were addressing the managers' biggest problems. She realized that if design momentum was to be maintained, her coaches had to be seen as responsible for three or four visible and high-impact wins a year.

Some enabling came from the very bottom of the organization. In 2008 two employees who had been at Intuit only four months designed an online social network for the D4D initiative, which they rolled out the following year with management's consent but without its direct support. In its first year the new platform, named Brainstorm, generated 32 ideas that made it to market.

From Presentations to Experiments

Traditionally, decisions at Intuit had been made on the basis of PowerPoint presentations. Managers would work to produce both (what they saw as) a great product and a great presentation for selling the concept to their bosses. Under this system Intuit managers voted on ideas and then tried to sell them to customers. A key component of D4D, therefore, was shifting the focus away from managerial presentations. It would be far better, Hanson and Cook realized, to learn directly from customers through experiments.

Today D4D innovations begin with what Intuit calls the painstorm—a process developed by two innovation catalysts, Rachel Evans and Kim McNealy. It is aimed at figuring out customers' greatest pain point for which Intuit can provide relief. In a painstorm, team members talk to and observe customers in their offices or homes rather than sit in Intuit offices and imagine what they want. This exercise often shatters preconceptions. Going into one painstorm for a sales-oriented product, the team was convinced that the product concept should be "Grow your business." But the painstorm showed that "Grow your business" sounded very ambiguous to customers—it could refer to growing revenues from their existing customers (not a pain point for them) or to acquiring similar small businesses (also not a pain point, but expensive). The true pain point was acquiring entirely new customers through organic

Recruiting the Innovation Catalysts

In 2008 Kaaren Hanson sent this e-mail to some Intuit colleagues:

Subject: Phase II of Design for Delight—we need YOU

You have been nominated (and your participation has been approved by your manager) to help us drive Phase II of Design for Delight at Intuit. You are a critical leader who can enable Intuit to become one of the principal design-thinking cultures. We have a number of levers at our disposal but we need your help to develop even better ideas to drive design thinking deeper into the organization.

Here's what you'll be committing to:

ACTIVELY PARTICIPATE IN A ONE-DAY BRAINSTORM/WORKSHOP in early August to work through what we (as a force of design thinking and as a larger company) might do to take Design for Delight to its next level. Scott will come by and respond to our ideas/plan towards the end of the day

COMMIT TO THE EXECUTION OF INITIATIVES generated through the August workshop

sales efforts. "Get customers" was a winning concept that focused laserlike on that.

Next, within two weeks, the group holds a "sol-jam," in which people generate concepts for as many product or service solutions as possible to address the pain points they've identified and then weed the concepts down to a short list for prototyping and testing. In the early days of prototyping, these high-potential solutions were integrated into Intuit's software development process. But the innovation catalysts realized that the best way to maintain momentum would be to get code into users' hands as quickly as possible. This would help determine whether the solution had potential and, if so, what needed to be done to enhance it. So the third step became moving immediately to "code-jam," with the goal of writing code that wasn't airtight but was good enough to take to customers within two weeks of the sol-jam. Thus, proceeding from the painstorm to the first user feedback on a new product usually takes only four weeks.

Let's look at a couple of examples. When Intuit's tax group began to think about mobile apps, Carol Howe, a project manager and innovation catalyst, started with the customer. Her five-person team went "out in the wild," she says, to observe dozens of smartphone users. It quickly narrowed in on millennials, whose income range made them likely candidates for the simplest tax experience. The team created multiple concepts and iterated with customers on a weekly basis. They brought customers in each Friday, distilled what they'd learned on Monday, brainstormed concepts on Tuesday, designed them on Wednesday, and coded them on Thursday, before bringing the customers in again. Through these iterations the team uncovered multiple "delighters." They launched a pilot in California in January 2010 and expanded nationwide in January 2011. The resulting application, SnapTax, has 4.5 stars in both the Apple and Android stores and a Net Promoter Score in the high 80s.

An even better example comes from India. In 2008 members of the India team came up with an idea remote from tax preparation and other core Intuit North America products, none of which were likely to succeed in India. The idea, a service for poor Indian farmers, was interesting enough for Intuit to give Deepa Bachu, a longtime development manager, the green light to explore it. Bachu and an engineer spent weeks following subsistence farmers through their daily lives—in the fields, in their villages, and at the markets where they sold their produce. The two came to appreciate the farmers' greatest pain point—perishable inventory that either went unsold or got a suboptimal price. If Intuit could enable the farmers to consistently sell their produce before spoilage and at a decent price, their pain would be reduced or eliminated.

After the painstorm and the sol-jam, the team went into rapid experimentation. Within seven weeks it was running a test of what was eventually launched as Mobile Bazaar, a simple text-messaging-based marketplace connecting buyers and sellers. To get there so fast, the team had cleverly faked parts of the product that would have been costly and slow to code and build. These came to be known as "fako backends." What the user saw looked real, but behind the user interface was a human being—like the Wizard of Oz behind the curtain—rather than thousands of lines of code that would have taken months to write.

The initial trials showed that half the farmers were able to increase their prices by more than 10%; some of them earned as much as 50% more. Within a year of launch, Mobile Bazaar had 180,000 subscribing farmers, most of them acquired by word of mouth. They report that, on average, the service boosts their prices by 16%.

BECOME A MORE VISIBLE DESIGN FOR DELIGHT LEADER across Intuit (e.g., help teach a Design for Delight 101 session/workshop to FastPath or some other such leadership session, contribute to the D4D body of knowledge through existing and future contribution systems, be a sounding board for Intuit execs)

BE A D4D COACH/FACILITATOR that the larger company can draw upon (e.g., coach key teams across Intuit in brainstorming, design reviews, etc.)

In total, your commitment will be about 2 days/month—and we'll be able to work around your schedule.

Let me know if you are in for FY09—and I'll get the August date on everyone's calendars. Right now, we're looking at an in-person workshop on August 4th, 5th, or 6th in Mountain View.

From Breakthroughs to Culture

Hanson was pleased with the progress of the 10 original innovation catalysts in their first year and with the organization's receptivity, but she knew that Intuit would have to scale up to make the transformation complete. Brad Smith, the new CEO, was raising innovation expectations for the whole company, focusing particularly on new arenas that he described as "mobile, social, and global." Hanson set a goal for FY 2010 to select, train, and deploy another 65 catalysts. This meant sourcing from a broader pool of talent—going deeper into product management and engineering—and creating a small dedicated team to support the catalysts and increase D4D pull from midlevel managers.

She appointed Suzanne Pellican, one of the original 10, to expand the catalysts' number and capabilities. Hanson had learned from the initial work that the strongest design thinkers didn't necessarily make the best catalysts. She says, "We not only needed people who were design thinkers—we also needed people with passion to give D4D away and help others to do great work, versus coming up with a great idea and bringing it to others."

The catalysts also needed mutual support. Hanson's team had found that they did their best work when they worked together. They learned new ideas and techniques from one another and provided moral support in tough situations. So as Pellican scaled up the catalyst corps, she made sure that each catalyst was part of an organized "posse" that typically extended across business units, allowing new methods to travel quickly from one end of the organization to the other.

To increase the catalysts' effectiveness, Hanson established a second small team—led by Joseph O'Sullivan, another of the original 10—to help middle management embrace both design thinking as a concept and the innovation catalysts as enablers. For example, after several catalysts reported encountering resistance at the director level, Hanson and O'Sullivan worked to integrate design thinking into Intuit's leadership training programs, applying it directly to problems that leaders faced. In one training program an IT director was challenged to lead a team tasked with reducing company spending on employees' mobile devices by $500,000. O'Sullivan's group held a one-day session on painstorming and soljamming for the team. The IT director achieved the desired saving and won much appreciation from the members of her team for having made their task so much easier than expected. She and the other participants in that leadership training program became fervent D4D advocates.

Employees have moved from satisfying customers to delighting them.

ENCOURAGING EXPERIMENTATION rather than PowerPoint has enabled employees throughout Intuit to move from satisfying customers to delighting them. Design for Delight has stuck because people see that it is an obviously better and more enjoyable way of innovating.

Innovation activity has increased dramatically in the organization. Take TurboTax, Intuit's single biggest product. In the 2006 tax year the TurboTax unit ran just one customer experiment. In 2010 it ran 600. Experiments in the QuickBooks unit went from a few each year to 40 last year. Intuit now seizes new opportunities more quickly. Brad Smith pushed for D4D-led innovation in the fast-growing arena of mobile apps, and within 24 months the company went from zero to 18, with a number of them, including SnapTax, off to a very successful start. Net Promoter Scores are up across the company, and growth in revenue and income has increased over the past three years.

Scott Cook may not have been another Steve Jobs, but it turned out that Intuit didn't need one.

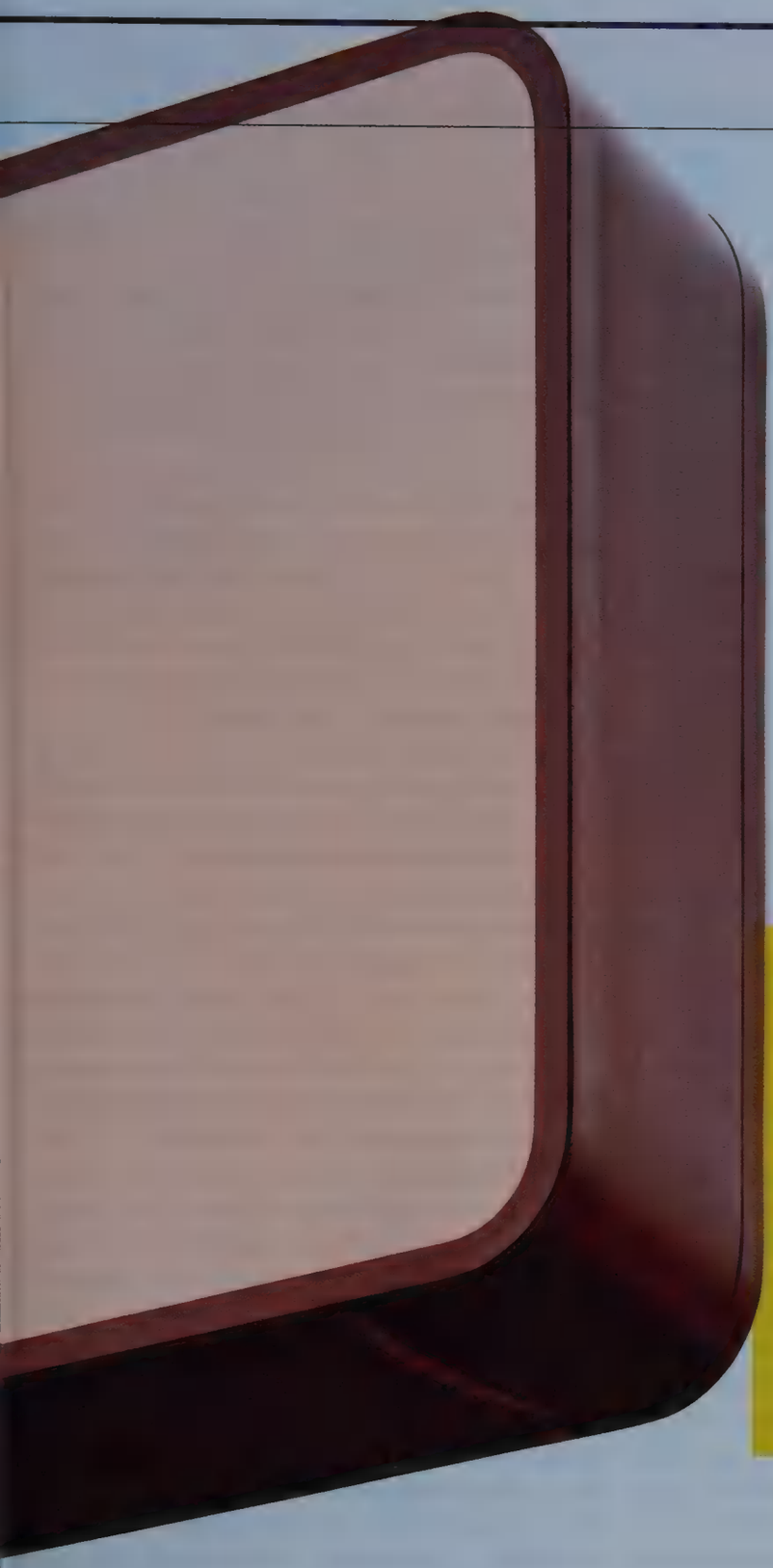
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Spotlight

ARTWORK Josef Schulz, *Brian Weiss,* 2009
C-print, 100 x 130 cm



Innovating On the Cheap



A practical guide to creating new products without starting from scratch

by Lance A. Bettencourt and Scott L. Bettencourt

RAIN BIRD is a unique business. But at the same time, it is like so many other businesses: Its product line is specialized—it makes sprinklers and other irrigation systems for lawns and gardens. To keep growing, it must continually introduce new offerings that appeal to consumers and excite retail channel buyers. And like most companies, Rain Bird has felt pressured to spend less on innovation in a down economy.

At the best of times, innovation investments can be painful. Typically, success rates are low, and returns on investment far from assured. The returns that do materialize, moreover, rarely do so in the short term. That makes innovation hard to justify when cash is tight—even when everyone knows it's essential to the company's long-term success.

How did it happen, then, that in 2010 Rain Bird was able to introduce a new product line, based on proprietary technology, and see an almost instant payback? Its Convert to Drip line, as it is called, enables a gardener to convert a portion of a watering system from sprinkler to drip action in a matter of minutes. That's a capability that both retailers and customers value. As we head into the 2011 summer season, sales of the new line continue to grow. (Note that one of the coauthors of this piece, Scott, was formerly Rain Bird's national retail sales manager.)

Rain Bird realized returns quickly because it was able to bring the Convert to Drip line to market only

nine months after it was conceived and to introduce it at a small fraction of the cost traditionally associated with new product development. And it could do that because the big-idea innovation at the heart of the new line wasn't actually brand-new at all. It was found in work that Rain Bird had already done.

The Bird in the Hand

Most managers think an innovation must be something absolutely, completely new—new to the world, ideally, and new to the company at the very least. Yet the reality is that almost all companies have previous discoveries with overlooked innovation or market potential. Those innovation prospects are the proverbial bird in the hand: The work is done, and the risks are low. All it takes to realize a substantial and swift payback is for the company to recognize what it has.

In the case of the Convert to Drip line, that bird in the hand was the DC-6, which had been on the market for a few years. Rain Bird's offerings featured two basic kinds of products: drip and spray. The DC-6 was part of the drip offerings, but it had an unheralded capability: It could replace a spray-head nozzle to get drip action out of what would usually be a sprinkler. At some point, Rain Bird noticed that something out of the ordinary was going on in one of its retail accounts. Sales of the DC-6 had suddenly taken off. The retailer's merchandiser, it turned out, had stocked the DC-6 alongside spray products rather than with the drip systems. The unexpected surge gave Rain Bird a new insight: It had underestimated the number of customers who would be interested in converting their sprinklers to drip.

Capitalizing on that realization was an easy next step. Rain Bird changed the name of the product and the messaging around it to reposition it for the job it filled. The company also expanded on the concept, creating variations focused on customers' needs to water trees and shrubs, vegetable gardens, or areas of mixed use (perhaps featuring some planters, some turf).

The success of Convert to Drip products illustrates how readily innovation can enhance the bottom line when it leverages assets your company already owns. The challenge, of course, lies in uncovering the hidden possibilities. In the following pages we'll explore the six distinct types of "innovation in hand" we've seen in companies and suggest ways that anyone can make the search for such opportunities more systematic.



SAVED FROM A SIDELINED PROJECT

A standout feature of Ryobi's lithium One+ products—their neon green color—was borrowed from research done for a canceled product line.

Failure to Launch

Whenever an innovative product is introduced, several stars have managed to align. Not only must the product satisfy a market need, but its pricing, technical performance, and channel appeal must be worked out, along with many other considerations. We know of great product ideas that never got off the drawing board because the manufacturing costs would be too high or because certain technical hurdles couldn't be overcome. Other innovative concepts have been rejected because they didn't jibe with key channel partners' goals. And sometimes a perfectly viable offering doesn't see the light of day because it is part of an entire product line that gets scuttled.

When a product concept fails to launch, it tends to be set aside and labeled a loser, if not utterly forgotten. But in almost every case, the considerable development time and funds expended on it yielded *something* useful—if not the whole concept, then some part of it—and that something might be just what's needed today. This turned out to be the case when Ryobi Tools introduced a 10-inch band saw in 2004 that featured a dust collection system called Silent Vac. That was a new concept to customers but rather an old idea to people at Ryobi: The Silent Vac had been developed years earlier for a benchtop sander that never made it to market.

It isn't only technical innovation that can be resuscitated after a failure to launch. A lot of fresh thinking, from promotional strategies to industrial design, goes into a new offering. In 2007, when Ryobi launched its line of lithium One+ power tools, it was able to draw on work from another sidelined project. The new tools had a lot going for them in terms of performance, but their initial appearance lacked punch. Home Depot buyers were interested but not excited. Ryobi looked back at some color research done for a product line that had been canceled and decided to use it for the lithium One+ products. The neon green that had tested well in that old research became a standout feature of the successful new line.

Ryobi's experiences suggest that a firm should create a storehouse of rejected product concepts and make a habit of revisiting it. In light of current projects and industry changes, is renewed potential there? Do the failed concepts have innovative features that might apply to different markets? Are the reasons that the innovation didn't fly even still relevant? Technology advances can overcome technical hurdles, and manufacturing advances can overcome product cost hurdles. If the obstacles have disappeared, the com-

Idea in Brief

Even when money is tight, it's possible to launch new offerings that excite customers and respond to unserved needs. The trick is to find assets already in hand that can be brought to market with minimal effort and resources.

Managers should look for six kinds of "in hand" innovation:

1. Innovations that were previously developed but never launched, owing to circumstances that may have changed.
2. Features of past products that may meet newly critical customer needs.
3. Existing offerings that should be repositioned, because customers like them for unforeseen reasons.
4. Elements of bundled offerings that could stand alone.
5. New combinations of elements, in which the bundled value to customers is greater than the sum of the parts.
6. Overdesigned offerings that could be pared down for less-demanding customer segments.

Innovation is associated in many minds with bold bets on next-generation solutions. But for marketers with little appetite for high risks and distant paybacks, an innovation in the hand is worth two in the lab.

pany may have an innovative product ready to go to market with only a modest investment.

Ahead of Their Time

Sometimes the route to low-cost innovation is not a product that never launched but one that did go to market—but had features that were not fully appreciated. The teams tasked with introducing an offering always face the challenge of framing its value proposition in the most concise and compelling way. To do so, they focus attention on a small set of important customer needs that the product satisfies in a distinctive manner. Usually, that laser focus means that not all the new product's benefits get communicated. Out of 10 good things that could be said about its unique and meaningful attributes, seven might go unmentioned.

Times change, however, and customer needs that were secondary in importance yesterday may be primary today. Often a company already has a product that meets the newly critical needs. Sometimes, the perfect product has simply been flying under the radar, but more often, a feature or a technological capability within a product has been overlooked.

When Rain Bird first introduced its innovative spray nozzles, the Dual Spray series, their number one selling point was that they solved a coverage problem. If you've ever used a spray sprinkler, you know the downside: As it moves through its compass points to water a large circle of lawn, it overshoots the area closest to the nozzle, leaving a brown spot. Rain Bird's solution to this problem was a nozzle with a second opening to distribute water within that zone. A by-product of this innovation was that less water was needed to cover the same area.

Today home owners don't like brown spots any better, but water conservation has become a major concern—especially given many municipalities' new restrictions on usage. As a result, Rain Bird has updated its positioning and begun actively promoting the increased efficiency of the Dual Spray series. The company has taken a capability it had all along—an innovation in hand—and by featuring it more prominently in communications to retailers, caused them to take a renewed look at the series for premium shelf placement and product bundling.

Create a storehouse of rejected product concepts, and revisit it regularly.

How can your company uncover innovative features or capabilities that are hiding within a current solution? The best way is to develop an up-to-date prioritization of customer needs and then reassess the capabilities of existing products in light of it. The good news is that product managers within your organization already possess the technical insight required for this task.

The trick is to identify not only the needs that are most relevant to customers now but those that may be in the future, and closely monitor how their significance to customers changes. Companies must focus on the job customers are trying to get done (in this instance, watering their lawns) and document the criteria by which they judge how well a product does it (the desired outcomes, such as minimal brown spots and less water use). Periodically examining those criteria will help companies discover product features that may be ahead of their time.



RENEWED BY REPOSITIONING

A surge in sales revealed that the DC-6 served a strong customer need Rain Bird had underestimated. Once Rain Bird changed the name and the messaging and added new variations on the product, it swiftly realized a substantial payback.

Limited Vision

Now let's turn to the type of innovation in hand Rain Bird found it had with its DC-6 product. What was going on there?

Sometimes an offering succeeds—to an extent—despite its marketing. Companies can launch products but have an imperfect understanding of how customers are using them or why they choose them. Ideally, of course, marketers understand the job that customers are hiring the product to do and tie its position, branding, and messaging to that job. But companies do not always make the connection between the product and the job clear. Sometimes customers are left to figure it out on their own. And fortunately, sometimes they do.

Whether by reading the fine print of brochures, talking with friends, or—most likely these days—interacting with people on the internet, customers find out about products that fill their needs even when the company behind them isn't getting the word out. The first hint may be an unusual blip on the sales radar as the product becomes popular even in the absence of advertising or other promotion. Unusual sales growth often coincides with an external trend that elevates the importance of a job the product does. (For example, kelp suddenly started flying off the shelves of California health food stores in March 2011, when fears of radiation from Japan's failed reactor made kelp's iodine, a natural defense against thyroid cancer, suddenly valuable to consumers.)

Rain Bird's customers had to discover on their own that the DC-6 was a solution to their need to convert spray nozzles to drip watering. It wasn't merchandised in the section of the store where its buyers—customers of spray products—were likely to shop. Its packaging didn't call attention to the job it got done. Even the product's name—a letter-number combination, like something out of a catalog—revealed a limited strategic vision.

It may well be that your company is also, thanks to limited vision, failing to capitalize fully on an offering. To find this kind of in-hand innovation, ask yourself: Have we made the connection clear between the products we offer and the jobs they help customers do? Have some jobs grown in importance since these products were launched? If so, can any of the products we already have help customers get them done?

Then there's the other way of asking the question: What products are seeing unanticipated applications? In the vernacular of the pharmaceutical industry, what "off-label" uses have come to light? Clearly, if such uses are ill-advised (as they are with medicines and other carefully regulated products), it's vital for the company to know about them and actively discourage them. But if customers are using a product in a perfectly valid way that the company had not thought about, the company may be sitting on an innovation. It may simply need to align branding and messaging with the new use. Alternatively, it may be able to optimize an existing product to perform the job customers are trying to do.



SPUN OUT OF A PACKAGE DEAL

Craftsman's work lights, which originally were bundled with other tools, became top sellers when sold as stand-alone products.

All Bundled Up

Companies often bundle products together, either to increase perceptions of value among customers or to simplify the purchasing decision by combining components of a solution. Sometimes the bundling involves selling complementary items, such as shampoo and conditioner or a computer and software, together. Other times, one product is being given away with the purchase of another, such as a toy with a kid's meal.

An in-hand innovation can be wrapped up in such a bundle, waiting to get out. The managers of Craftsman, a brand of tools owned by Sears, discovered precisely such an opportunity by happenstance in 2005. In a focus group convened to learn customers' opinions of a line of power tools, a participant lambasted Craftsman for a promotion bundling a work-space light with a cordless drill. Skeptical of the "free with purchase" offer, the participant figured the price must actually include the cost of the light, and he hated the idea that he might have paid more because of it. However, when the moderator inquired if he would like Craftsman to take his light back, the answer was a resounding no. "That light is my most used tool," the participant said. "I wish I had another." With that, a metaphorical light went on for the Craftsman marketers who were watching. The work-space light had never been offered for sale on its own; it had only been bundled with the drill to promote sales. Clearly, it had the potential to succeed as a stand-alone offering.

Within six months, Craftsman launched its new line of C3 power tools. It included multiple products that already existed in the company's portfolio but had previously been offered only in bundles or kits. Among them were the Craftsman C3 19.2-volt Work Light and the Craftsman C3 19.2-volt Fluorescent Light. Within two years of their introduction, those lights were the two top sellers in the entire C3 line, with the exception of replacement batteries.

To uncover an innovation that is currently all bundled up, a company should first ask sales and customer service personnel if customers are trying

If customers are using a product in a valid way you hadn't thought of, you may be sitting on an innovation.

to buy individual items within a bundle. That is a leading indicator that the items can satisfy a need above and beyond other solutions on the market. The other questions to consider are these: Do any products or services that we offer only as part of a bundle address jobs for which customers already hire or might hire stand-alone solutions? Are some features or services in a bundled offering more innovative than others in helping customers get a job done? Affirmative responses to either question suggest opportunities to disaggregate bundles and offer innovations individually.

Unrelated Family

If companies can discover innovation-in-hand opportunities by selling some bundled items separately, the opposite is also true: They can create considerable additional value by selling previously unbundled items together. Many companies overlook such meaningful opportunities because they fail to consider product and service complementarities from the customer's perspective of getting an entire job done.

Until 2004, Microsoft viewed its Software Assurance offering simply as a vehicle for the efficient purchase of upgrades. In exchange for a flat fee, corporate customers who signed a multiyear contract received operating system upgrade rights. However, with renewal rates declining, Microsoft looked at upgrades from a different angle: as one step in the job of managing the life cycle of a software license. That life cycle included assessing upgrade needs, implementing licensing renewals, and managing software licenses once purchased. Microsoft realized that Software Assurance was helping customers with just one tiny piece of that job. Many of the customers' most important unmet needs related to the other steps in the job.

The company also realized that it had already developed products that would help customers satisfy those needs and get the entire job done; they had just never been packaged together in a cohesive and compelling offering. For example, customers were having difficulty anticipating potential software incompatibilities when they deployed a new operating system. Microsoft already had a tool that addressed this problem—one that it had been using internally. This tool and many others were subsequently introduced to the market as part of a redefined Software Assurance offering. In the year Microsoft announced the changes to Software Assurance, the offering beat its sales goal by more than 10%, and renewal rates and revenue have continued to grow ever since.

To discover innovative ways of bundling current products, a company must first take a step back and ask: What job do these products help a customer get done? Keeping in mind that the same product can be hired for multiple jobs, the company should identify all the possibilities.

Next, the company should take a particular job and consider the steps required to execute it completely. Those steps may include determining goals and resource needs, gathering required inputs, preparing or setting up, verifying readiness, carrying out the core job, assessing job execution, making required adjustments, and finishing the job. By looking at the products and services that customers hire for each step, a company can identify innovative bundling opportunities.

Overdesigned for the Masses

Companies tend to focus their innovation efforts on the most demanding customers. To address these customers' unmet needs, they introduce next-generation products and services that provide enhanced performance. But something curious happens along the way: Value begins to deteriorate for many people in the market because the cutting-edge offerings are overdesigned for their use. In that situation, a company can find innovation-in-hand opportunities by reducing the number of product features for the less-demanding segment and creating what Clay Christensen has called a "good enough" product. Usually, it takes very little development time and few resources to bring a pared-down product to market.

Although this strategy is relevant even when the economy is strong, it's especially relevant during

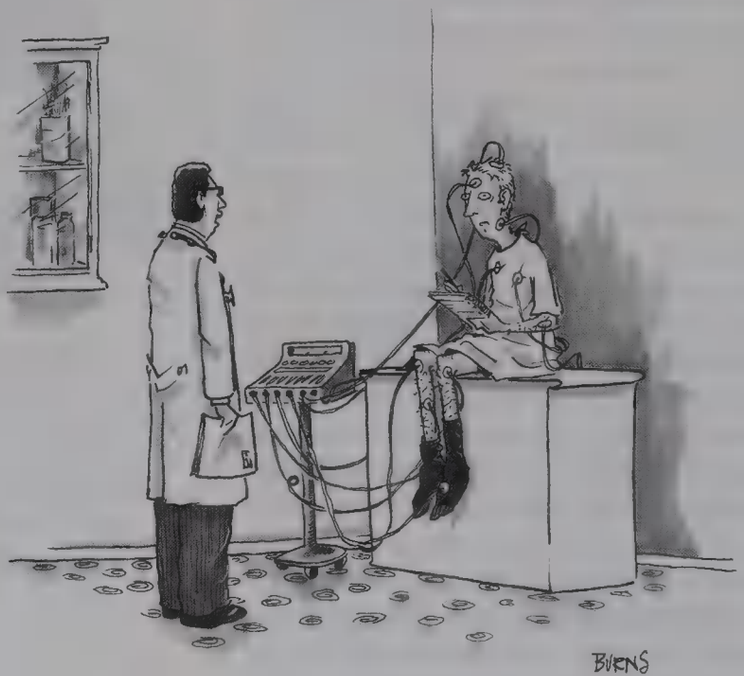
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Offering fewer features can make your product line accessible to new segments and expand your market.

economic downturns, as customers look to trim their spending. Simplifying a product may not seem very exciting, but a company must consider the costs of inaction. If your company can do it, so can your competitors, and it's better to beat them to the punch. The upside is that an offering with fewer features can expand the entire market by making a product line accessible to segments that hadn't considered it before.

Craftsman found itself in this position a few years back with its C3 cordless drill. Although demanding users appreciated the capabilities of the drill, many features were simply overkill for the typical user, who needed it only for the occasional home repair. To reach this user and introduce him to the C3 line of power tools, Craftsman created a drill with a gearbox that had one speed instead of two, 125 inch-pounds of torque instead of 410 inch-pounds, a three-eighths-inch keyless chuck instead of a half-inch one, and one battery instead of two. These changes required only simple tooling and motor modifications and did not undermine the quality of the drill. In the year the one-speed drill was introduced, the C3 line gained twice as many new users as expected, Craftsman estimates. Originally intended as a onetime promotion, the drill was such a hit that it's now a standard part of the C3 line.

In our experience, nearly every market—whether it's composed of surgeons conducting hip replacements or do-it-yourselfers completing home repairs—has segments that are more demanding and segments that are less demanding. A product is overdesigned for a segment if its members don't consider the secondary and tertiary needs the product addresses to be important. A company should ask itself if features can be pared back or removed because they are intended to satisfy needs of relatively low importance to the segment. Once again, a focus on the job customers are trying to get done and the outcomes they use to assess how well an offering does it will help companies identify more- and less-demanding customer segments.



"For this next segment of your employee physical we'll monitor how well you can work out that problem while I scream berating statements at you."

AS PETER DRUCKER once wrote, a company has only two basic functions: marketing and innovation. To win customers and stay ahead of the competition, innovation is critical. However, in searching for the next great thing, companies should be careful not to overlook commercially viable offerings that they already have under their noses. These can be brought to market faster and more cheaply than ideas still on the drawing board, and often, at much lower risk. To amend the familiar proverb: An innovation in hand is worth two in the lab.

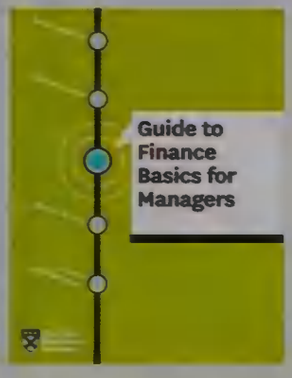
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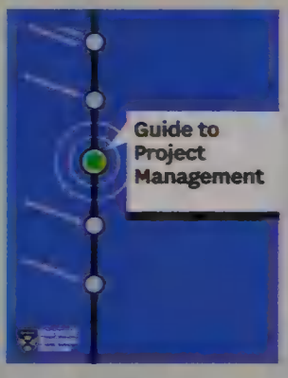
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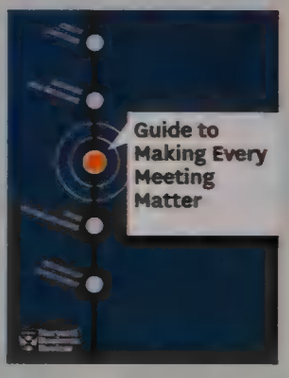
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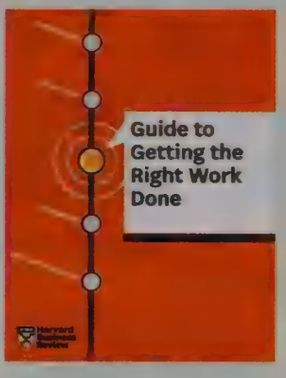
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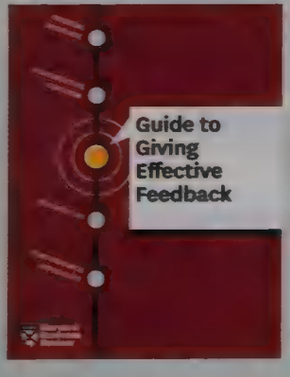
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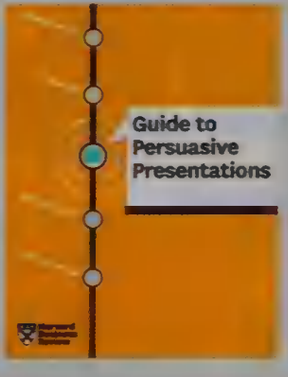
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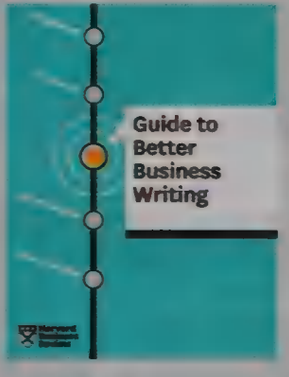
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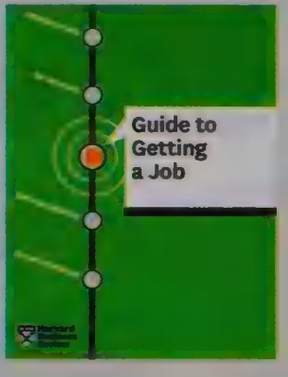
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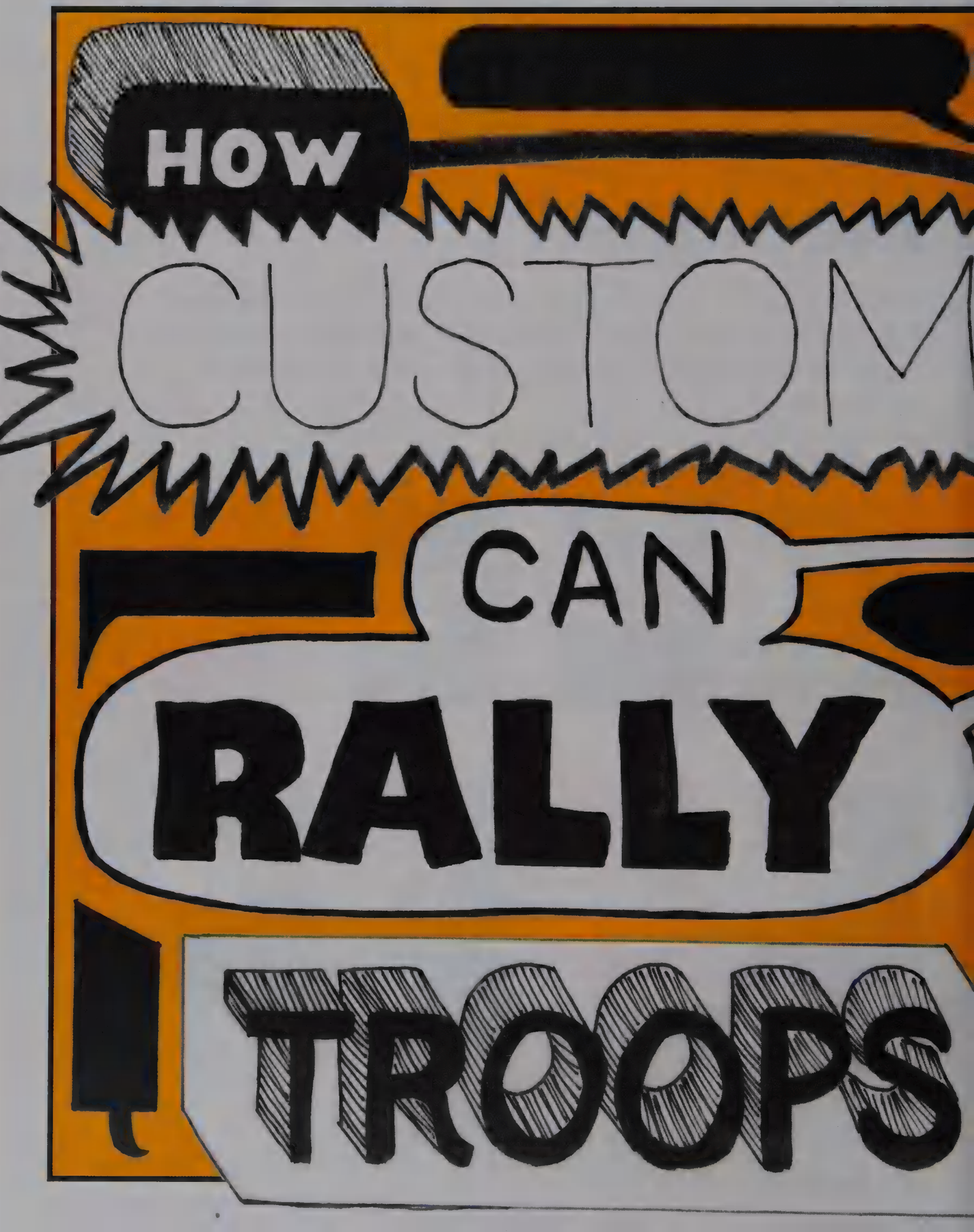
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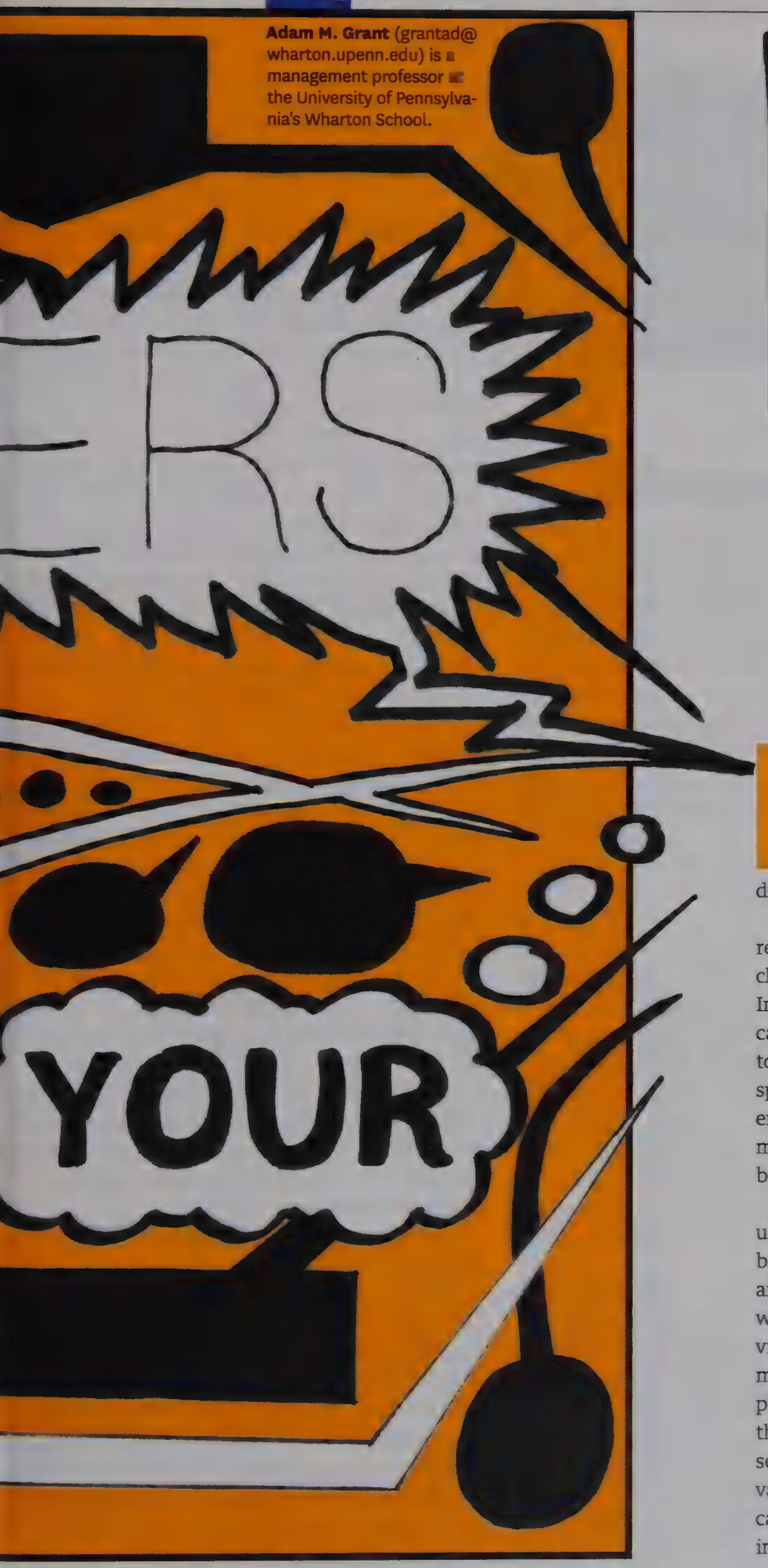


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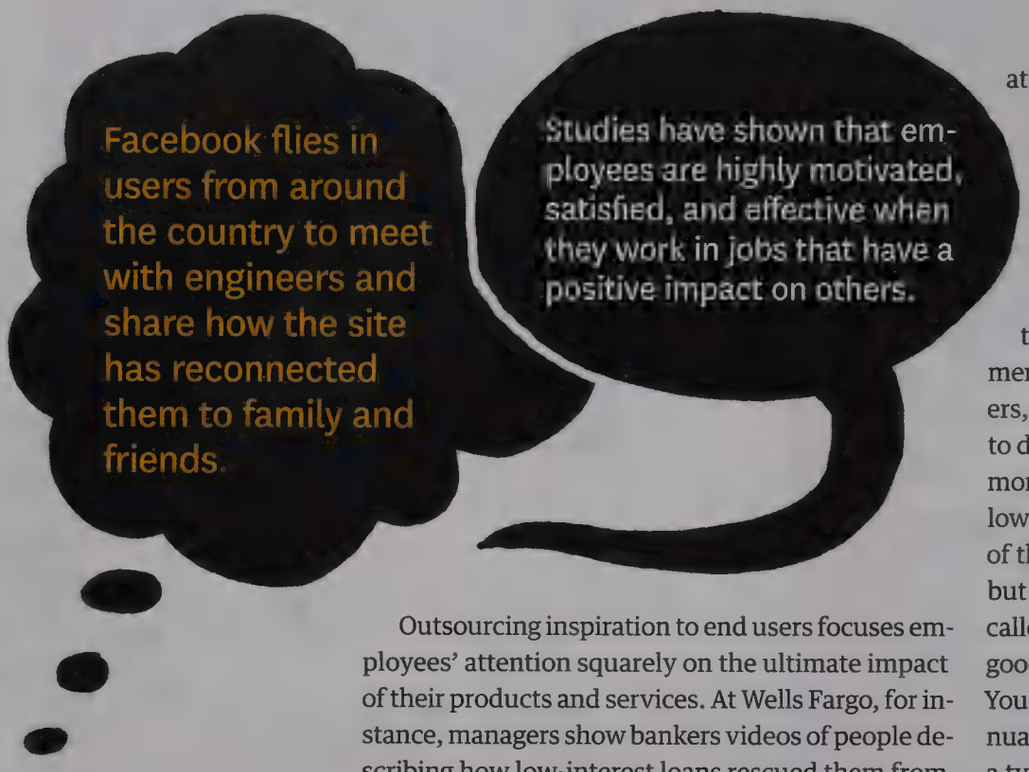
Adam M. Grant (grantad@wharton.upenn.edu) is a management professor at the University of Pennsylvania's Wharton School.

End users can energize your workforce far better than your managers can. *by Adam M. Grant*

How did a five-minute meeting motivate university fundraisers to increase their weekly productivity by 400%? How did a photograph drive radiologists to improve the accuracy of their diagnostic findings by 46%?

Was it managers who inspired such enormous results? Perhaps they gave an amazing speech or set clearer goals or tracked performance more carefully. In fact, in both situations, managers were not the catalysts. They did not assume that they alone had to bear the burden of motivating employees with inspiring messages. Instead, they tapped in to a powerful force that encouraged workers to go the extra mile. They *outsourced inspiration* to those who were better suited to the job.

A growing body of research shows that end users—customers, clients, patients, and others who benefit from a company's products and services—are surprisingly effective in motivating people to work harder, smarter, and more productively. A brief visit from a student who had received a scholarship motivated the fundraisers to increase their efforts. A photograph of a patient they had never met inspired the radiologists to read X-rays more accurately. By serving as tangible proof of the consequences and value of employees' efforts, end users such as these can be important allies for leaders in motivating and inspiring their workforces.



Outsourcing inspiration to end users focuses employees' attention squarely on the ultimate impact of their products and services. At Wells Fargo, for instance, managers show bankers videos of people describing how low-interest loans rescued them from severe debt—a vivid reminder to the bankers that they are striving to serve their customers, not their managers. But the power of end users goes beyond their ability to put a name and a face to employees' efforts. Organizational psychologist David Hofmann and I have found that employees generally see end users as more credible than leaders as sources of inspiration. When leaders attempt to deliver inspiring messages, many employees react with skepticism, questioning whether leaders are just trying to get them to work harder. Indeed, researchers Phil Mirvis and Donald Kanter have found that in many companies, the majority of frontline employees are cynical about leaders' motives and intentions. End users, however, can deliver convincing testimonials of their experiences with the company's products and services, showing that leaders' messages are more than rhetoric. Outsourcing inspiration to end users can also keep the content fresh: Leaders can call on multiple customers to deliver distinct messages.

For these reasons, leaders should abandon the notion—popularized in the mainstream business press—of themselves as lone heroes who must rally their employees to do great things. Leaders need help bringing their visions to life, and end users are uniquely suited to this task. In this article, I show how leaders can take full advantage of opportunities for connecting employees to the people affected by their work. Outsourcing inspiration is not about eliminating leaders from the picture; it's about creating a partnership that can enhance the meaning employees derive from their jobs and move them to do their best work.

Employees Without a Cause

The most powerful evidence I've gathered that connecting employees with end users yields motivational benefits comes from a series of experiments with university fundraising callers. These callers, whose sole responsibility is to convince alumni to donate money, face motivational challenges common in many sales and service jobs: repetitive work, low autonomy, and rude customers. A large portion of the donated money is used to fund scholarships, but the callers don't see or meet the recipients. One caller had posted a telling sign on his wall: "Doing a good job here is like wetting your pants in a dark suit. You get a warm feeling, but no one else notices." Annual turnover rates in this field can exceed 400%: In a typical three-month period, the entire staff quits, creating exorbitant hiring and training costs.

As part of my research, I have invited several thousand executives to propose ways to motivate the callers to increase their efforts to bring in donations. Most executives start from the assumption that employees are ultimately self-interested, proposing performance incentives such as pay increases, promotions, recognition, food, and breaks—interventions that the fundraising managers had already tried, to no avail.

Rarely do executives suggest imbuing the work with greater meaning and purpose. In fact, fewer than 1% say that managers should show the callers how their work makes a difference. This is consistent with the attitudes of the managers themselves: They give the callers no information about how the donations are used or who benefits from them. Like the executives, they assume the callers are driven by self-interest and simply don't care.

But there's a wealth of evidence that people want to do meaningful work: In national surveys over the past three decades, the vast majority of Americans have identified meaningful work as the single most important feature that they seek in a job. And numerous researchers have found that people are concerned not only about themselves but also about doing work that benefits others and contributes to society.

Once they are armed with this knowledge, executives often suggest that managers deliver inspiring speeches about how the donations are used. But are

Idea in Brief

Leaders who connect employees with end users motivate higher performance, measured in terms of revenue as well as supervisors' ratings. Research shows that when leaders are the sole source of inspiring messages, employees often question whether the messages are true. End users, in contrast, are seen as credible sources who can deliver convincing testimonials of their experiences with a company's offerings.

Customers, clients, patients, and others who benefit from a company's products and services motivate employees by serving as tangible proof of the impact of their work, expressing appreciation for their contributions, and eliciting empathy, which helps employees develop a deeper understanding of customers' needs.

Leaders can "outsource inspiration" to end users (both past and present) by collecting their stories, inviting them to the organization, introducing them to employees, and recognizing employees who make a difference in customers' lives.

such messages more powerful coming from a person who benefited from the donations? To test this idea, I invited one scholarship recipient to visit a group of fundraisers who worked in an office filled only with telephones and fellow callers. The student spent five minutes describing how the callers' work had funded his scholarship, how it had made a difference in his life, and how much he appreciated their effort. One month after this visit, the callers showed average increases of 142% in weekly time spent on the phone and 171% in money raised. Callers in two control groups, who did not meet the scholarship student, showed no significant changes in performance. In a second study of callers contacting alumni who donated more frequently to the university, the performance effects following a visit from a scholarship recipient were even more striking: A month later, the callers had on average more than doubled their calls per hour and had achieved average weekly revenue increases of more than 400%, from $411.74 to $2,083.52. In a third study, one group of callers met with a scholarship recipient, another met with a manager who described a student who had benefited from the callers' efforts, and a third group had no intervention. Only the first group experienced any performance improvement.

The Art of Motivation Maintenance

The high-burnout field of fundraising might feel like an extreme example, but my research suggests that outsourcing inspiration is effective in a wide range of settings. Three basic mechanisms are at work. The first is *impact:* Employees see for themselves how their work benefits others. This is readily apparent in companies whose products save lives. At Medtronic's annual holiday party, for instance, patients are invited to share their stories about how the company's medical technologies helped them. The stories humanize the work for the engineers and technicians behind the scenes. But employees who make less dramatic contributions can also be inspired by real-life examples of the impact of their work. At Wells Fargo, when bankers hear a customer describe how a loan has enabled her to buy a house or pay off major debts, they gain a richer understanding of how their work makes a lasting difference.

Gratitude from end users is a powerful reminder of the value of continued quality improvements.

The second mechanism is *appreciation:* Employees come to feel valued by end users. At Let's Go Publications, where teams of editors revise travel books, managers circulate letters from readers who have relied on the company's advice to navigate foreign countries and experience new cultures. These signs of gratitude let editors know their efforts are appreciated. Similarly, at Olive Garden, leaders share with staff members letters from customers describing how they chose to celebrate meaningful events at the company's restaurants. Even though employees know intellectually that their contributions make a difference, gratitude from end users is a powerful reminder of the value of continued quality improvements and innovation.

The third mechanism is *empathy:* Employees develop a deeper understanding of end users' problems and needs and thereby become more committed to helping them. For example, researchers Rajesh Sethi and Carolyn Nicholson recently found that when product development teams had contact with customers, they were more likely to create offerings that exceeded projections for sales and mar-

When You Can't Find End Users

Connections between employees and end users are most powerful when they are face-to-face. How can leaders build those connections when they lack access to end users or can't find any with inspiring stories? Research suggests three options:

Show pictures.

Even a snapshot of an end user can be powerfully motivating. Consider the case of radiologists who study X-rays to diagnose illness without ever meeting the patients. A study by Yehonatan Turner and colleagues showed that radiologists who saw photos of patients increased the length of their reports by 29% and improved the accuracy of their diagnoses by 46%. Microfinance organization Kiva uses the same approach, showing potential donors pictures of the social entrepreneurs requesting funding.

A note about choosing effective photos: Research by Deborah Small and Nicole Verrochi suggests that people are more likely to empathize with end users who appear sad or neutral and thus may be signaling an unfulfilled need.

Circulate inside stories.

When employees share with one another their stories about experiences with end users, they can create a venue for mutual inspiration. At Ritz Carlton hotels around the world, employees meet daily for 15 minutes to share "wow" stories about going the extra mile to make a difference in customers' lives. In sharing these tales, employees inspire not only one another but also themselves. It turns out that the simple act of sharing a story about benefiting others can reinforce one's conviction about the purpose of a job. In one study, Jane Dutton and I found that employees who kept a weekly journal about how their work made a difference worked harder and achieved higher performance.

Share outside stories.

Employees such as bank examiners, airline pilots, and nuclear power plant workers do jobs that are designed to protect people, but they rarely see the impact of their work. Stories from outsiders can help. When I gave lifeguards a few short news stories about other lifeguards who had rescued swimmers, they showed improvements in the month following: They viewed their jobs as more meaningful and valued, volunteered to work more hours, and spent more time and energy protecting the safety of swimmers—as measured by their supervisor's ratings. Lifeguards who read stories about only the personal benefits of the job showed no improvements. The director was stunned. Lifeguards surely know that their actions can save lives, but they don't feel it viscerally and emotionally until they're directly exposed to vivid examples of how their work can affect living, breathing human beings.

ket share. And at Microsoft, leaders learned that a personal connection can help software developers adopt the perspectives of end users. A Microsoft lab manager interviewed by researchers Michael Cusumano and Richard Selby explains that after seeing an end user, developers "immediately empathize with the person. The usual nonsense answer—'Well, they can just look in the manual if they don't know how to use it,' or 'My idea is brilliant; you just found ten stupid people'—that kind of stuff just goes out the door." A face-to-face connection with end users appears to elicit empathy among the developers, motivating them to design software with users in mind.

Even simple reminders of the existence of end users can increase employee motivation. Consider an experiment that David Hofmann and I recently conducted in a hospital. Medical professionals are aware of the importance of hygiene, yet many studies suggest that they wash their hands only about a third as often as they should. We placed signs on units around the hospital near soap and gel dispensers available to doctor and nurses. The first sign read, "Hand hygiene prevents you from catching diseases." The second sign replaced "you" with "patients."

We then tracked soap and gel usage for two weeks after the signs were introduced. We were surprised to find that the second sign yielded average

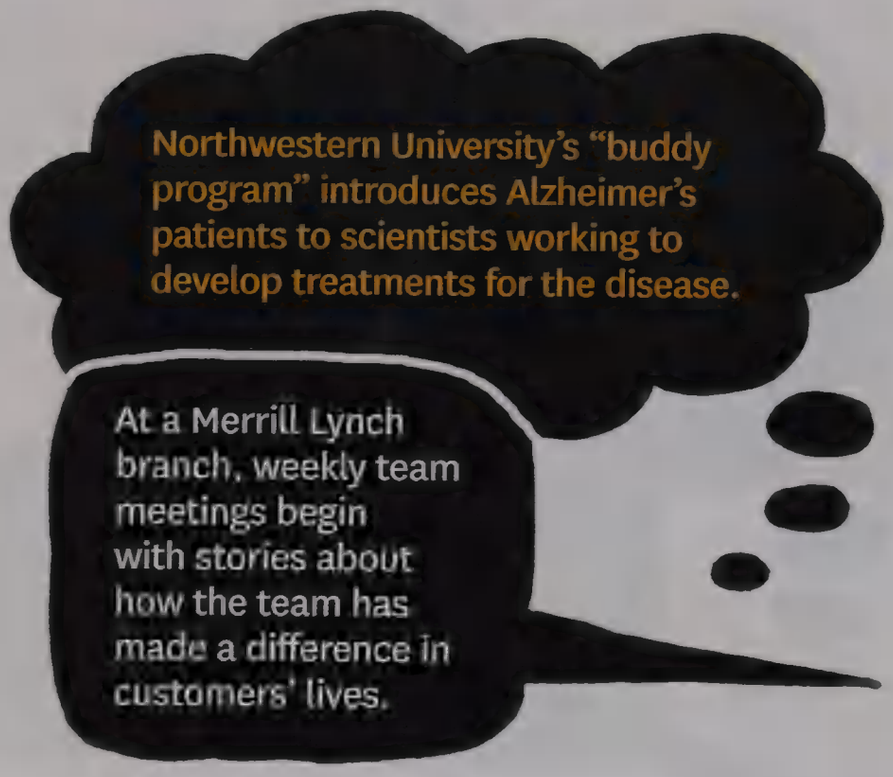
increases of 33% in soap and gel usage, whereas the first sign had no effect. Why? Research shows that medical professionals are overconfident about their immunity to disease but are much more realistic when evaluating the risk to patients, who are often highly vulnerable. This study suggests that a mere mention of end users can make the consequences of one's work more vivid and produce an increase in beneficial behaviors.

A Leader's Guide to Outsourcing Inspiration

Relatively few companies seize opportunities to create motivating connections between employees and end users. Many leaders are simply unaware of those opportunities; others may be concerned about abdicating their roles as visionaries. But as I noted earlier, strong leaders are essential in effectively outsourcing inspiration. In my recent studies of sales and government employees, I found that inspirational leadership and connections to end users operated in tandem to motivate higher performance, measured in terms of revenue as well as supervisors' ratings. End users complemented rather than substituted for leadership, bringing the leader's vision to life and strengthening employees' beliefs that their contributions mattered.

To outsource inspiration effectively, leaders must build and leverage their networks to find end users, collect their stories, invite them to the organization, introduce them to employees, and recognize workers' contributions. How can they accomplish this?

Identify past, present, and future end users. Many leaders mistakenly assume that they know who their end users are. For example, researcher Michael Tushman writes of senior managers at a large food products company that sold jars of pureed, strained, and chopped foods, such as meats, fruits, and vegetables. The managers were marketing the jars as baby food, assuming that their customers were parents of infants. But during a routine trip to a grocery store, one of the Florida sales team members discovered a hidden end user: elderly people, who were buying the products because they needed food that was easy to eat and digest. In addition to opening up a new market segment, this discovery alerted the company to a new category of end user who valued the company's products. To connect with the broadest possible range of end users, ask leaders, managers, and employees at different levels of the organization to identify various groups of clients, customers, suppliers, patients, and other recipients who have benefited, currently benefit, or could benefit from the work that employees do.



Dig up feedback from past end users. Many organizations regularly collect useful information from focus groups and customer surveys that ends up trapped in silos or viewed strictly as marketing research to facilitate customer outreach and product development. This kind of feedback, no matter how old, can provide powerful examples of a company's impact on end users. For example, when Bob Austin joined Volvo in 1970 as a customer service representative, he received many unsolicited letters from people who had been in accidents and were writing to say that medical professionals and police officers had told them that they would have been killed if they had not been driving a Volvo. Two decades later, Austin became the head of public relations and created a club for Volvo drivers who believed that one of the automaker's cars had saved their lives. He tracked down past letters and invited the customers to join the club. Since then, Volvo's contributions to customers' lives have been more visible. Similarly, in my studies with fundraising callers, I discovered that the organization had a database of thank-you letters from grateful scholarship recipients. Managers had simply never considered sharing the letters with the callers.

Seek out new stories. When employees lack a strong sense of impact, appreciation, and empathy,

Hundreds of studies have shown that people who have contact with a member of a different racial, ethnic, age, functional, or occupational group exhibit decreased prejudice toward that group. This suggests that direct interaction can help employees see end users in a more-positive light.

"All Medtronic employees have a 'defining moment' in which they come face-to-face with a patient whose story deeply touches them," writes former Medtronic CEO Bill George.

or when a particular group of end users is invisible, managers and employees can go into the field. At Medtronic, more than two-thirds of procedures using the company's medical devices are attended by an engineer, salesperson, or technician. As former Medtronic CEO Bill George explained to me:

> Employees need to remember when they get frustrated that they're here to restore people to full life and health. If I'm making semiconductors, how do I get to see the impact on patients? If I'm doing software development and there's a glitch in a defibrillator, people could be harmed or killed. Put it in those terms, work becomes very personal...It's very important that employees get out there and see procedures...it's a way of communicating what we're all about.

Of course, these stories are most effective when they are shared not as vehicles for maximizing the bottom line but as genuine efforts to bring greater meaning to the work. Leaders who consider it their moral responsibility to help employees see the actual and potential consequences of their work are likely to inspire their employees; those who attempt to connect with end users just for a performance boost risk fostering cynicism and skepticism among the workforce.

Set up events and meetings where end users can share their experiences. My research shows that although stories and letters can be motivating, a face-to-face connection with end users has a stronger emotional impact on employees. These sessions are most inspiring when they include end users whom employees do not normally see. For example, Deere & Company invites farmers who are buying tractors to visit the factories with their families. Assembly line employees get to meet the farmers, hand them a gold key, and watch them start their tractors for the first time. At Raytheon, military troops speak at divisional meetings, describing how a division's product saved their lives. An employee reflected that "putting names, faces, and stories with the individuals using our products certainly portrayed the point of our mission." (See the sidebar "When You Can't Find End Users" to learn how to outsource inspiration when face-to-face meetings aren't possible.)

Turn employees into end users. Employees who have little experience with the company's products or services often contribute more after they spend some time in customers' shoes. For example, at Four Seasons Hotels, employee orientations conclude with a "familiarization stay" in which housekeepers and clerks spend a night in their own hotels to experience the service firsthand. As a vice president of learning and development explained, "They're learning what it looks like to receive service from the other side." At outdoor gear company Cabela's, retail employees can borrow fishing and camping equipment and write a review, which helps them understand the customer's perspective.

Find end users inside the organization. Internal end users—such as a customer-facing team audited by backroom accountants or investment bankers who give client presentations prepared by junior consultants and analysts—are prime sources of feedback. For example, Francesca Gino and I found that when a manager from another department visited a call center to thank employees for their contributions, those employees increased their effort by 51% during the following week, whereas employees in a control group did not. Connecting with internal customers can be a powerful step toward reducing misconceptions and conflict between groups and departments.

Engage employees who currently do low-impact work. Finding ways to connect end users to employees who seem to deliver few direct, lasting benefits can require a bit more creativity. One way is to leverage their unique knowledge and expertise. For example, Best Buy has created

Homer Simpson or Ned Flanders: Which Employees Are Most Motivated by End Users?

Are all employees equally motivated by seeing their impact on end users? Not necessarily.

Consider the personality trait of conscientiousness: the degree to which people are responsible, disciplined, and goal-oriented (think Ned Flanders from *The Simpsons* animated TV series) versus carefree and spontaneous (think Homer Simpson). One might assume that highly conscientious employees, because they prize dependability and responsibility, would care more about connecting with end users. In a recent study, however, I found the exact opposite to be the case. The Ned Flanders types tend to operate at a high motivational ceiling, performing well regardless of feedback. The Homer Simpsons, on the other hand, depend heavily on external cues about why their work is important.

The good news is that connections with end users are most effective with the very employees who most need to be motivated.



HOMER SIMPSON
CAREFREE, SPONTANEOUS



NED FLANDERS
RESPONSIBLE, DISCIPLINED, GOAL-ORIENTED

CONSCIENTIOUSNESS

Twelpforce, a service that lets employees across the company, regardless of their job descriptions, use Twitter to respond to customers' questions and inquiries. In its first year, more than 2,600 Best Buy employees from across the company—including those who did not normally play customer-facing roles—joined Twelpforce and responded to more than 27,000 inquiries. At Whole Foods, employees whose jobs involve unpacking boxes and stocking shelves have the opportunity to educate shoppers about allergies, organic food quality standards, sustainable agriculture, and environmental preservation and recycling; some even teach cooking classes. Of course, it is important to make sure that employees have the knowledge, skills, and time to take on new responsibilities.

Spread the message. Outsourcing inspiration is in large part a communications task. It is useful to organize events with end users, create videos, and post their stories on websites and intranets. For example, St. Luke's Hospital hosts a Night of Heroes event, during which patients are reconnected with the trauma teams that saved their lives and all team members are honored for their contributions. Senior leaders speak at the event, demonstrating its importance.

Recognize high-impact contributions. Because leaders are often unaware of episodes of excellent customer service, coworkers can help identify them. Zappos, Google, Southwest Airlines, and Linden Lab all have peer bonus and recognition programs in which employees can commend and reward coworkers who have made outstanding contributions. When stories about these contributions go viral, they can be particularly potent: Spontaneity can signal that colleagues are genuinely motivated to make a difference.

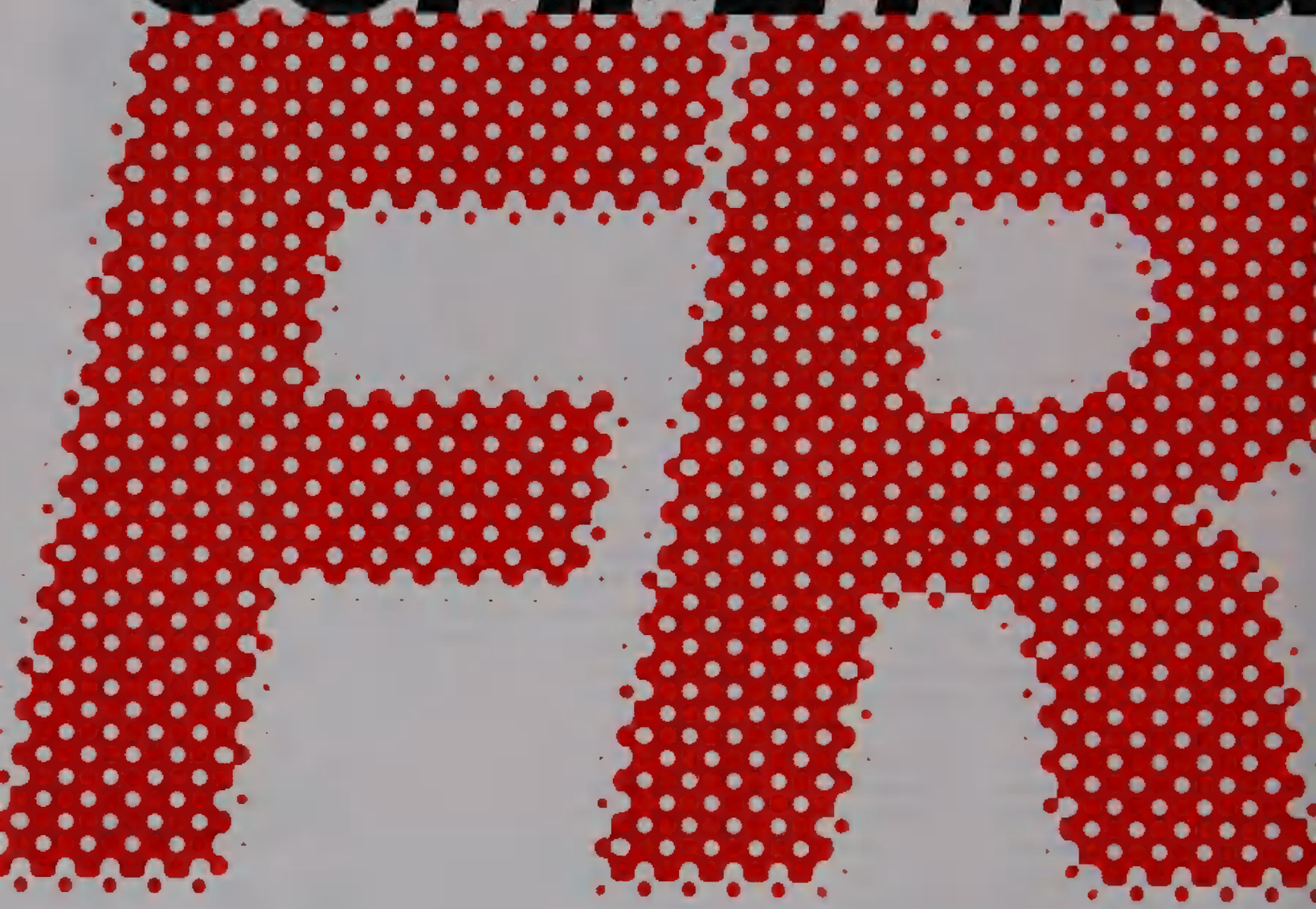
OUTSOURCING INSPIRATION can have a significant, lasting effect on employees' motivation, performance, and productivity. When customers, clients, and patients describe how a company's products and services make a difference, they bring a leader's vision to life in a credible, memorable way. Employees can vividly understand the impact of their work, see how their contributions are appreciated by end users, and experience stronger concern for them. By connecting employees to end users, leaders can motivate through their actions, not only their words. Their inspirational messages become more than lip service.

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"It's all about who you've sniffed."

COMPETING



FREE OFFERINGS ARE RAPIDLY SPREADING BEYOND ONLINE MARKETS TO THE PHYSICAL WORLD. HERE'S HOW INCUMBENTS CAN FIGHT BACK.

BY DAVID J. BRYCE, JEFFREY H. DYER, AND NILE W. HATCH

AGAINST



A new competitor enters your market and offers a product very similar to yours but with one key difference: It's free. Do you ignore it, hoping that your customers won't defect or the free product won't last? Or do you rapidly introduce a free product of your own in an attempt to quash the threat? These are questions faced by an increasing number of companies—and not just in the digital realm. The "free" business models popularized by companies such as Google, Adobe, and Mozilla are spreading to markets in the physical world, from pharmaceuticals to airlines to automobiles.

How should established companies respond? Clearly, managers are having difficulty figuring this out. For the past five years, we have been studying how incumbents have dealt with competitors employing free business models in a variety of product markets. (See the sidebar "About the Research.") We have found no examples of companies in the non-digital realm that have prevailed against rivals with free offerings. In fact, in two-thirds of the battles that



Even companies with formidable assets are slow to fend off free-product competitors. The reason: the ubiquity of the profit-center structure and mind-set.

have progressed far enough to be judged, incumbents (both digital and physical) made the wrong choice. In a handful of instances, companies that should not have taken action did so immediately by introducing their own free offering—hurting their revenues and profitability. They should have either waited and allowed the attacker to self-destruct or recognized that the two could peacefully coexist.

More commonly, companies that should have taken action didn't do so quickly enough or at all. Surprisingly, these included incumbents that had identified a genuine threat from a new entrant and had all the weapons they needed to win a head-to-head battle: an established customer base, superior product features, a strong reputation, and abundant financial resources.

Why didn't these companies use their formidable assets to fend off free-product competitors? The answer is so obvious that you've probably guessed it: Managers were reluctant to abandon an existing business model that was generating healthy revenues and profits. But if the answer is obvious, why did managers make this mistake? The reason is the ubiquity of the profit-center structure and mind-set. Drawing from our research on free offerings in online and physical markets, we explore in this article how to assess whether the introduction of a free product or service in your market is a threat and how to overcome the profit-center challenge.

Assessing the Threat

The seriousness of the threat posed by a new entrant hinges on three factors: the entrant's ability to cover its costs quickly enough, the rate at which the number of users of the free offering is growing, and the speed with which your paying customers are defecting.

Some new competitors self-destruct because they can't convert nonpaying customers into paying ones fast enough to cover costs or because they can't find a third party that will pay for access to their users. So it's crucial to determine if the competitor's free offering is generating revenue in some way. Of course, some companies may have enough funding to wait a year or more before they need to monetize their user base. (For example, Skype offered its free phone service for a year before it introduced SkypeOut, a paid service for calling landlines from a computer.) But this scenario can actually benefit an incumbent by giving it time to assess the potential of the model and decide whether to launch its own free product.

We learned that an entrant will usually find a way to turn users into revenue-generating customers if its user base is growing rapidly or if the incumbent's paying customers are defecting to the free offering at a high rate. What rates signal danger? Our examination of the dynamics in a number of markets suggests that if the free offering's user base is growing by 40% or more a year (meaning that it will at least double every two years) or your customer defection rate is 5% or more a year (meaning that you stand to lose at least 25% of your customers within five years), serious trouble may be looming. As the matrix "How Big a Threat Is 'Free' Competition?" shows, assessing those rates (or reasonable estimates of them) helps a company determine the level of threat from the free product and respond accordingly.

Choosing Whether and When to Respond

When both rates mentioned above are high, the entrant represents a *business model* threat. Most established companies must not only respond with a free offering but also radically change their business model to survive. And they need to do so pretty quickly—within two or three years. Many newspapers competing against online rivals that offer free classified advertising or editorial content are in this quadrant. They will continue to deteriorate sharply without a fundamental rethinking of their business model.

Fortunately for incumbents, most threats wind up in one of the other quadrants, which means there may be more time to respond. When the entrant's users are multiplying rapidly but the established firm's customers are defecting slowly, the entrant represents a *delayed* threat. This means the free product or service is attracting either customers from other established competitors or brand-new users. In such cases, your offering can coexist with the free one for at least a few years—especially if yours is targeting

Idea in Brief

Business models that involve offering a product or service for free and making money in other ways are spreading beyond the digital realm. But managers of threatened companies are having difficulty figuring out how to respond: An ongoing study has found that some companies respond too quickly but most don't do so quickly enough—even when they have sufficient resources.

To assess the threat, incumbents should consider the entrant's ability to cover its costs quickly enough, the rate at which the number of users of the free offering is growing, and the speed with which paying customers are defecting.

A bigger challenge is overcoming the ubiquitous profit-center structure, which discourages managers from giving away offerings. The remedy is to move P&L responsibility to a senior management group and to assign revenue stream and cost management oversight to separate lower-level groups.

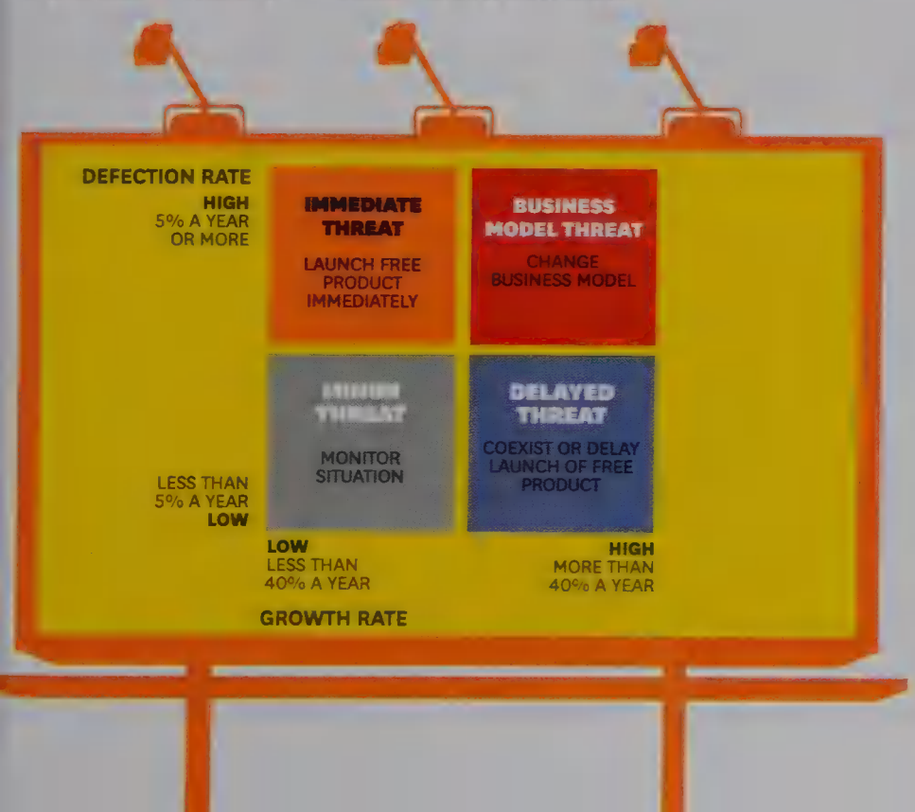
premium segments. This is the situation that Microsoft finds itself in with its Office software: Because of the high switching costs, most current enterprise users aren't defecting, but new users—college students, small businesses, and educational institutions—are increasingly using Google Docs and Oracle's Open Office, both of which are free. (See the sidebar "Why Microsoft Should Take Its 'Free' Competition More Seriously.")

The trick for incumbents facing delayed threats is figuring out exactly when to respond with either a free version of the existing offering or a new free product that appeals to new users. Responding sooner rather than later allows an incumbent to beat back the entrant and probably won't significantly hurt existing sales (because established customers are switching slowly). As soon as the entrant's users are in the millions, however, the incumbent must respond—as Intuit did when it acquired upstart Mint.com for $170 million in 2009, eliminating a threat to its Quicken personal finance software and gaining a free online product. (Mint.com had attracted more than 2 million users in just three years.)

When the defection rate among your paying customers is high and the growth rate of the entrant's users is low, the threat is obviously *immediate* because your revenues are rapidly eroding. Even though the free offering has not yet attracted a large following, it's a problem for you and demands a prompt response. It also suggests that you are overserving your customers and thereby inviting disruption. You must quickly figure out a way to launch a free offering.

Finally, when both rates are low, the threat is *minor*. In these cases, the incumbent should continue to monitor the situation.

HOW BIG A THREAT IS "FREE" COMPETITION?



Offer a Better Free

If you've established that free offerings are a threat to your business and have considered the timing of your response, the next step is to figure out *how* to respond. Most incumbents can successfully counterattack by unleashing their arsenal of weapons, which typically includes a large base of users or customers who have made investments in learning how to use the product, advanced technical know-how, substantial brand equity, significant financial resources, knowledge of the market, and access to important distribution and marketing channels. Incumbents can use those assets to introduce a better free product and to employ some tried-and-true sales and pricing strategies to generate revenues and profits: up-selling, cross-selling, selling access to customers, and bundling the free product with paid offerings. (See the sidebar "Four Tried-and-True Strategies.")

Yet, as we mentioned above, incumbents often fail to counterattack. A widely known case in point is the reluctance of almost all major newspapers in the United States to embrace a free business model when Craigslist attacked their profitable classified-ads business. According to our research, Salt Lake City is the only top 50 U.S. metropolitan market for classified ads that is not dominated by Craigslist. The reason? Deseret Media (which includes the *Deseret News*, KSL TV, and KSL NewsRadio) responded quickly to the business model threat by launching its own free classifieds site and making other significant changes. The site, ksl.com, is better developed and easier to navigate than Craigslist, and it leveraged the established KSL brand to attract classified ads.

Deseret Media quickly benefited from network effects: More buyers went to ksl.com than to Craigslist because more sellers were posting there. The site generates revenue by charging advertisers that want to post regular ads as well as classified sellers who want preferred positions. The site's profits now exceed those of the traditional businesses, including the newspaper.

Meanwhile, Deseret Media has changed the newspaper's business model by cutting nearly half its staff and crowdsourcing some of its content. In 2010, the paper increased its print and online audience by 15%, the second-highest growth rate in the industry. Overall, Deseret Media is thriving.

Yahoo is another example of an incumbent that prevailed by introducing a better free product. In 2004, Google launched its free Gmail service, which provided 10 times more storage than Yahoo, the leading provider of free e-mail at the time. As a new entrant, Google could afford to offer significantly more storage because it had relatively few users. A Google executive told us, "We don't do something unless it is an order of magnitude better—maybe five to 10

COMPANIES THAT PREVAILED

Personal finance software company **Intuit** responded to the threat from free rival Mint.com by purchasing the company. Mint.com, which makes money by selling access to its user base, lets Intuit maintain a free offering separate from its popular Quicken product.

Yahoo, the leading provider of free e-mail, responded to Google's entry by matching, and then exceeding, Gmail's free storage offer.

Four Tried-and-True Strategies

1. UP-SELL

Introduce a free basic offering to gain widespread use and then charge for a premium version.

REQUIREMENTS

- A free product that appeals to a very large user base so that even a low conversion rate of users to paying customers will generate substantial revenues **or**
- A high percentage of users willing to pay for the premium version

EXAMPLES Virtually every iPhone app uses this strategy. One tactic is to offer a free version of the product to consumers and a premium version to the business market, as Adobe does with its Reader software.

Skype, which offers free computer-to-computer calls and charges for add-ons, succeeds with up-selling because it has more than 400 million users, many of whom become paying customers. Flickr, the free photo-sharing site, has a much smaller user base and a low conversion rate. That explains why eBay paid $2.6 billion for Skype, and Yahoo paid less than $30 million for Flickr.

2. CROSS-SELL

Sell other products that are not directly tied to the free product.

REQUIREMENTS

- A broad product line—preferably one that complements the free product—**or**
- The ability through partnerships to sell a broad line of products to users of the free product

EXAMPLES Ryanair offers roughly 25% of its airline seats free but cross-sells a variety of add-on services, such as seat reservations and priority boarding. Once on the plane, the customer is sold food, scratch-card games, perfume, digital cameras, MP3 players, and other products. (Ryanair employs a second strategy: charging third parties for in-flight advertisements.) Specialty pharmaceuticals company Galderma rebates out-of-pocket costs for Epiduo, a prescription acne gel, and cross-sells other skin care products.

times better—than what others are offering, particularly if we have to get users to switch from another free product to ours."

Google's entry created a dilemma for Yahoo, which generated some revenue from up-selling (persuading users to pay for more storage or other add-ons) but much more from advertisers (its real customers). To match Google's offer, Yahoo would have had to buy warehouses of servers to provide storage for its 125 million e-mail users—an investment that would have generated no additional revenues.

Yahoo decided to respond in a way that sent a message to Google and to its own e-mail users and advertisers: It immediately announced that it would match Google's offer of one gigabyte of free storage. A couple of years later, it began to offer unlimited storage. Those moves left Yahoo users with no reason to switch to Google—and left Google with few options for offering a better free product. Although the increased costs hurt Yahoo's profits in the short term, the company's share of the e-mail market continues to be several times larger than Google's. But Google has not given up: Gmail now serves as a platform for the company's other free products, such as Google Docs and Calendar. In the long run, this could make Gmail the better free product.

The most important lesson from these cases? If your user base is vital to your revenue stream, you must quickly offer a free product that is comparable or superior to the new competitor's. If you can, you should try to crush that competitor or at least prevent it from becoming powerful enough to mount a serious challenge.

COMPANIES THAT IGNORED THE THREAT

The major airlines in Europe have been slow to respond to **Ryanair,** which offers free or deeply discounted tickets and charges for other services. Ryanair has made impressive gains in Europe; its share now exceeds that of Air France.

Satellite radio company **SiriusXM,** which offers subscription packages for its more than 180 channels, has done nothing to stem the loss of share to Pandora, which provides free radio over the internet and generates revenue by charging for ad-free service and selling access to its user base to third parties.

Rethink Profit Centers

Two obstacles prevent managers at established companies from making the leap to free strategies. The first is the deeply rooted belief that products must

3. CHARGE THIRD PARTIES

Provide a free product to users and then charge a third party for access to them.

REQUIREMENTS

- A free offering that attracts either many users who can be segmented for advertisers or a targeted group that makes up a customer segment **and**
- Third parties willing to pay to reach these users

EXAMPLES Google, which charges companies to advertise to its millions of users, is the poster child for this strategy. Another example is Finnish telecommunications company Blyk, which offers 200 free cell-phone minutes a month to 16-to-24-year-olds who fill out a survey and agree to receive ads. Blyk then sells access to and information about them. Blyk was recently acquired by Orange, the largest brand of France Telecom.

Generating users does not guarantee success. Xmarks offered web-browser add-on tools that attracted more than 2 million users—and plenty of venture capital. But the company recently shut down because it couldn't deliver a clear segment to advertisers.

4. BUNDLE

Offer a free product or service with a paid offering.

REQUIREMENTS

- Products or services that can be bundled with the free offering **or**
- A free product that needs regular maintenance or a complementary offering

EXAMPLES Here the "free" effect is largely psychological—the customer must buy the bundle to get the free product. Think of Hewlett-Packard, which often gives away a printer with the purchase of a computer.

Better Place plans to lease electric cars in Israel by bundling a free lease with a service contract. Customers would pay to swap out their battery packs.

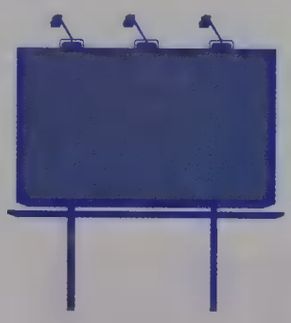
Banks are increasingly bundling free services, such as accounts and stock trades, with paid services, such as investment accounts that require minimum balances. But the bundled product doesn't have to be related to the free one. Banks also give away iPods, iPads, and other products to customers opening accounts.



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generate a respectable level of revenues and profits on their own. The second is the profit-center structure and the accounting system it employs, which both reflect and reinforce this mind-set.

In stable competitive environments, profit centers are a godsend: They push P&L accountability down, usually to the product level; they place revenue and cost streams in the hands of an individual, clearly identifying where the buck stops; and they provide a career ladder for those hoping to oversee units with larger budgets. But profit centers have a dark side: They make it impossible for an organization to consider a product's revenues and costs separately—a perspective that's essential for conceiving and implementing a free-product strategy.



To fix this problem, profit responsibility must be pushed up to a management group that oversees revenue and cost streams from a much wider variety of sources than traditional profit centers do. Clearly, a company that relies primarily on free-product strategies, such as Google, will place this responsibility much higher in the organization than one that uses free offerings as a small part of a more comprehensive strategy.

In addition to moving profit responsibility higher, companies with free business models generally place responsibility for revenue streams and cost management at lower levels, and in separate hands. *Revenue managers* in these companies pursue all possible ways to increase revenues—except product price. Clearly, the job requires creativity, but revenue is typically generated in the four ways mentioned above: up-selling, cross-selling, selling access to users, and bundling.

A separate set of *product development managers* is responsible for overseeing costs and building in product features that will expand the user base as rapidly as possible. On the basis of conversations with current executives at Google, we estimate that only the CEO and three or four senior vice presidents have P&L responsibility there.

Clearly, tensions can arise between the revenue group and the product development group, and

Why Microsoft Should Take Its "Free" Competition More Seriously

For the past four years, Microsoft's Office software has been under attack from free alternatives: Google Docs and Oracle's Open Office. Although Microsoft finally responded in 2010 with Microsoft Live, a free "cloud" version of Office, it waited too long and was not forceful enough to contain what could become a serious threat.

Microsoft's reluctance to embrace a free-product strategy is not surprising. Its office applications business has long enjoyed a near monopoly and has been highly profitable. And except for price-sensitive users such as college students and public entities, its customers have not flocked to the free products. Indeed, concerns about file incompatibility, the lack of functions in competing products, and the need to teach employees how to use new applications have kept the vast majority of Microsoft's target corporate customers in the fold.

But in our view, Microsoft has erred in not taking the defection among price-sensitive customers more seriously. Our survey of college students suggests that nearly 20% now exclusively use free alternatives, up from about 4% five years ago. According to a competitor, the number of students in the United States using Google Apps has increased from 7 million to 10 million in the past two years, and about 3 million small-business users and some large institutions (including Brown, the California State University system, Gonzaga, the University of Minnesota, the University of Virginia, Vanderbilt, Villanova, and William & Mary) have adopted it as well. This is a big problem for Microsoft: Open Office and Google Docs will continue to improve, becoming more attractive to younger and newer users as well as price-sensitive institutions—especially those overserved by the function-laden Office suite.

So far, Microsoft Live doesn't seem to be effective in countering the free offerings of its competitors. There are several possible reasons. One is that Microsoft, unlike Open Office, doesn't offer a version that can be downloaded to and operated from an individual computer. Another is that Microsoft has not promoted its free product aggressively enough, and, as a result, it is not as well-known as Google Docs.

Judging from Microsoft's half-hearted response to date, the company doesn't want customers switching to its free product. This is a mistake. By sacrificing a portion of revenues from price-sensitive or overserved customers, Microsoft could prevent free-product competitors from expanding their foothold and give itself a better shot at retaining its most valuable customers: the business and power home users who are loyal today but could ultimately defect.

it pays to spell out how they will be resolved. For example, Google's product development group can nix revenue models it believes would damage the user experience. When the two groups can't resolve disagreements, the senior managers with P&L responsibility—and sometimes even the CEO—arbitrate.

Another culprit that undermines many companies' ability to offer free products is the cost accounting system, which is excellent for averaging costs across large numbers of products and then allocating overhead but not for identifying the *actual* cost of the last product or service sold. The distinction between average cost (what some call variable cost or total cost) and actual cost (what some call marginal cost) is important because the latter is almost always lower than the former, often dramatically so. Think of what it costs an airline to fly an empty seat on an otherwise full or mostly full airplane: essentially nothing. This principle applies in nearly every industry. Once an operation is up and running and costs are largely incurred, generating additional products or services adds very little to total costs. Company leaders can use this notion to their advantage as they consider alternative pricing approaches, such as free offerings. By stepping back from the cost accounting system, they may find flexibility they didn't realize they had.

An example from the pharmaceutical industry illustrates how the profit-center structure and mind-set and the cost accounting system make it difficult for established companies to react when rivals offer free products or services. In 2008, specialty pharmaceuticals manufacturer Galderma (a joint venture of Nestlé and L'Oréal) launched Epiduo, a prescription acne lotion, in the United States. Because Benzac, its other acne product, was about to lose U.S. patent protection, Galderma felt tremendous pressure to build Epiduo's U.S. market share as quickly as possible. But in Europe, the product had met stiff competition from Duac, an acne gel made by GlaxoSmithKline (GSK). Expecting more of the same in the United States, Galderma decided to implement a program to reimburse a patient's out-of-pocket costs for the product for as long as a year. In exchange for rebate coupons, customers gave the company their e-mail addresses. Galderma then sent them skin care tips, acne information, and special offers for its non-prescription products, such as cleansing bars.

Heavily rebating new drugs in the early days to build market share is a common strategy in the pharmaceutical industry. The hope is that once the company has won a substantial share, health insurance companies will agree to cover the drug, allowing the company to offset its development costs and make a profit before its patents expire.

But incumbents selling established drugs are generally unwilling to take risks with pricing. Their cost accounting systems and P&L structures make them feel that they must cover their substantial product costs—which explains why GSK and other incumbents seemed paralyzed when Galderma launched the rebate program for Epiduo. One GSK executive told us, "We can't afford to match them, and we can scarcely afford to discount. So we're losing share."

In reality, the marginal cost—the material and labor—of a tube of lotion or gel is small (from a few pennies to a few dollars). Therefore, in the short run incumbents would have lost almost nothing if they had deeply discounted their products or matched Galderma's rebate. Moreover, like Galderma, they could have cross-sold products and, by breaking down the walls around P&L centers, used profits from other highly successful products to subsidize short-term losses in dermatology. This would have forced Galderma into the untenable position of giving away its product without growing share. The battle is ongoing, but so far Galderma's strategy has allowed it to gain customers and profitably cross-sell products.

BECAUSE FREE-PRODUCT strategies entail experimentation and, admittedly, some risk taking, embracing them may require a cultural shift. Strong executive leadership will be needed to build the case for mounting a competitive response, revamping organizational structures, and questioning cost accounting information. When a free offering is a threat, few strategies are available besides meeting free with free. Incumbents that spend too much time looking for some other killer strategy often only defer the inevitable. By taking decisive action as soon as the threat is clear, incumbents can survive and thrive.

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About the Research

For five years, we have been studying companies that face competition from rivals offering free products and services. The 34 incumbents we've been following are in 26 product markets representing the digital and physical realms as well as the intersection of the two. The markets include airlines, automobiles, classified advertising, dermatology pharmaceuticals, internet services, music, office applications, operating systems, personal finance software, radio, and telecommunications. Twenty-four of the battles between incumbents and free-product rivals have progressed far enough for us to judge the incumbents' actions. In two-thirds of those cases, the incumbents made the wrong choice: They introduced their own free offering too quickly, responded too slowly, or did nothing at all.

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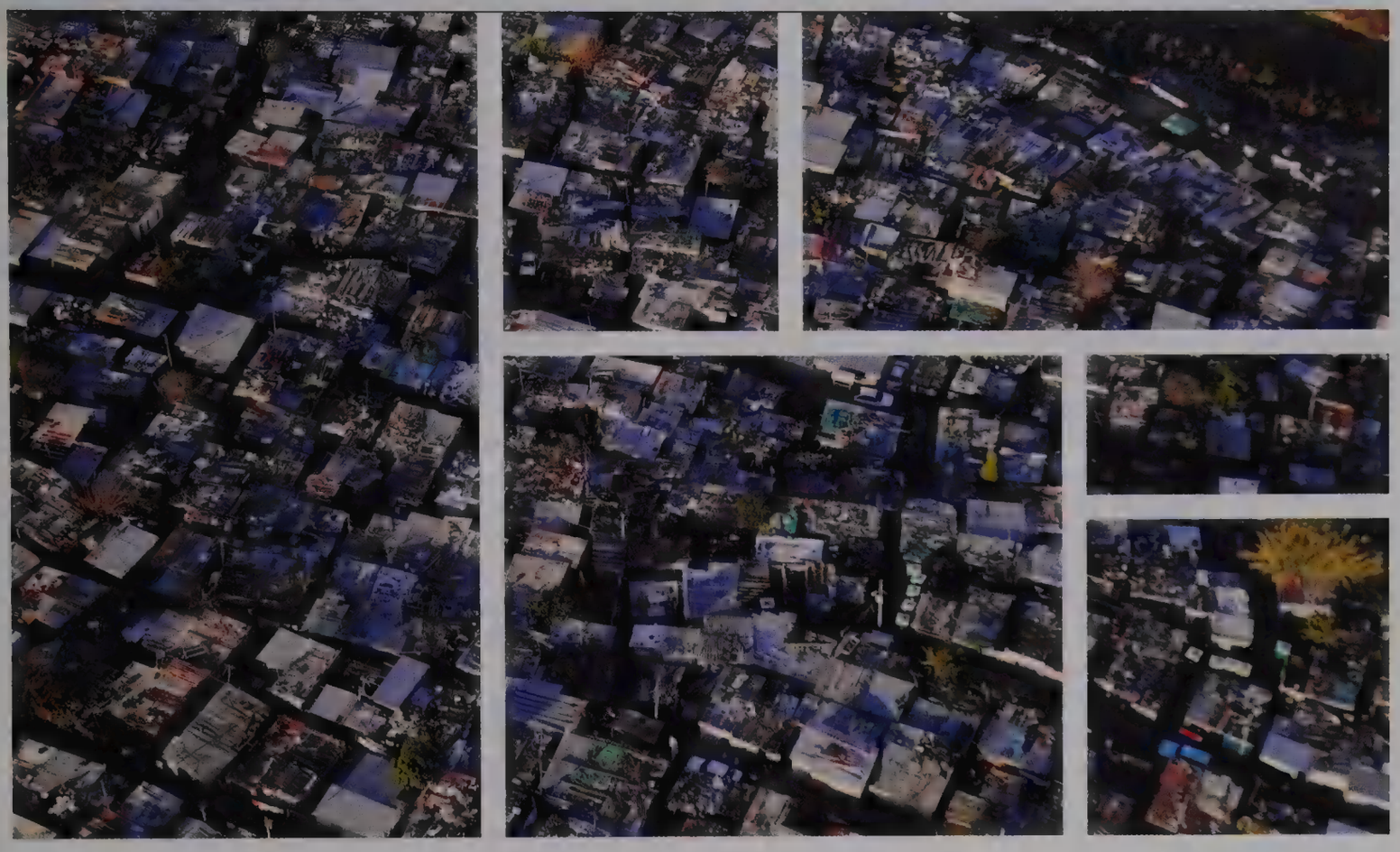
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Segmenting the Base of the Pyramid

To succeed, you'll need to link your commercial interests with your constituencies' well-being.

by V. Kasturi Rangan, Michael Chu, and Djordjija Petkoski

Cross the invisible line into the base of the economic pyramid in emerging markets and you enter a world of pitfalls. If a company embarks on an initiative that focuses solely on commercial gain, civil society and governments are likely to oppose it intensely, as the international water utility company Aguas del Tunari discovered in Bolivia. If a company tries to stay under the radar by keeping its base-of-the-pyramid operations small, profits are likely to be meager, as Procter & Gamble found out with its water-purification product in Latin America and Asia. Even if you focus mainly on social impact and consider profits secondary, the base of the pyramid is a risky place: Projects that fail to make money will eventually be relegated to companies' corporate social responsibility departments, as Microsoft discovered.

Our research has shown a way to traverse this difficult landscape. Indeed, decent profits can be made at the base of the pyramid if companies link their own financial success with that of their constituencies. In other words, as companies make money, the communities in which they operate must benefit by, for example, acquiring basic services or growing more affluent. This leads to more income and consumption—and triggers more demand within the communities, which in turn allows the companies' businesses to keep growing. A corollary of that principle is that from the very beginning, scale is critical: Tentative forays into the base of the pyramid do not yield success.

Which Value-Creation Strategies Work Best at the Base of the Pyramid?

LOW INCOME
$3–$5 A DAY
1.4 BILLION PEOPLE

SUBSISTENCE
$1–$3 A DAY
1.6 BILLION PEOPLE

EXTREME POVERTY
BELOW $1 A DAY
1 BILLION PEOPLE

All four of these strategies can be applied throughout the base of the pyramid, but each has a sweet spot in one of the income segments.

1	2	3	4
Providing appropriate and affordable products and services directly to consumers	Enlisting individuals or small businesses to provide efficient reach and coverage	Engaging the community to coproduce value—for example, in the supply chain	Forming commercial partnerships with governments and NGOs
Sweet spot: LOW INCOME	**Sweet spot:** SUBSISTENCE	**Sweet spot:** SUBSISTENCE	**Sweet spot:** EXTREME POVERTY

Business models that call for creating private and public value while aiming for scale are gradually becoming more prevalent. Hindustan Unilever has succeeded by training tens of thousands of sales and distribution agents. The Afghan mobile network operator Roshan has succeeded by doing the same for small retailers. The local communities' growing economic health boosts profits and prosperity for everyone along the value chain.

In studying dozens of companies over many years, we have found that those with skill at simultaneously building private and public value tend to have a nuanced understanding of their constituencies. The 4 billion people at the base of the pyramid—whose output represents one-third of the world's economy—are not a monolith. To emulate the most effective pioneers, companies must commit to learning what constitutes value for the various components of this population. The way to start is to divide the 4 billion people into three basic segments.

Segmenting by Living Standard

The simplest way to analyze the base of the pyramid is to recognize that the income level of $1 a day separates the extremely poor from everyone else, and that people above that demarcation can be roughly divided into those earning $1 to $3 a day and those earning $3 to $5 a day. It's not the only way to categorize this tier of the pyramid, but it's a useful one.

Low income. The adults among the roughly 1.4 billion people who live on $3 to $5 a day typically have a couple of years of secondary education and the skills needed to enter the job market. Many earn semiregular incomes as construction workers, petty traders, drivers, or low-level staff in public and commercial establishments. They conduct their transactions in both formal and informal markets, and they tend to live near or among the people who occupy the next layer up in the pyramid—those with incomes of just over $5 a day. Families in the $3 to $5 segment often own such consumer goods as bicycles, televisions, and cell phones. As they strive for higher education and steadier, better-paying work, they need good housing and access to credit and to health care specialists. Many of them have a reasonable hope that they or their children will achieve a modestly higher living standard.

Subsistence. The bulk of the roughly 1.6 billion people who live on $1 to $3 a day are poorly educated and low skilled. Although they typically have some income as day laborers or temporary workers, their earnings are not steady. Many need improved sanitation, health care, and education. They can typically afford one square meal a day, but the nutritional content is often substandard. If they live in slums or shantytowns, they might work as helpers or assistants in petty trade. In rural areas, they are likely to be temporary, migratory farmhands during sowing or harvesting seasons. As both consumers and producers, they conduct transactions in informal markets, which often bustle with activity but are inefficient because they lack infrastructure and supportive institutions. Without bank accounts or access to formal credit, they turn to moneylenders for loans at exorbitant rates and are vulnerable to exploitation by middlemen. Unlikely to reach a $5-a-day standard of living, they nonetheless strive to improve their circumstances. They need gainful employment and inexpensive items for day-to-day living.

Extreme poverty. The bottom 1 billion lack basic necessities: sufficient food, clean water, and adequate shelter. War, civil strife, and natural disasters have displaced many from their homes. They are forced into transactions that are irregular even by the standards of informal markets. Some live in barter economies; others are bonded laborers. Women often have to walk long distances along nonsecure pathways to fetch water. Poor health, lack of nutrition, financial vulnerability, limited education, and a dearth of marketable skills shut them out of the organized economy. The precariousness of their daily existence precludes participation in the market as consumers or producers. The lucky ones receive aid from nonprofit and international agencies or government relief programs.

Segmenting by Value-Creation Role

In addition to segmenting the people at the base of the pyramid by standard of living, businesses need to understand the roles those people can play in the value-creation relationship: as consumers, coproducers, or clients.

Consumers. Companies can provide value to consumers by directly addressing their needs for services such as clean water, better sanitation, education, and credit. A

more indirect way is to introduce innovations that enable people to devote fewer resources to basic activities and more to other pursuits. If all their costs and hours are fully taken into account, people at the base of the pyramid often turn out to be paying premiums for, and wasting a great deal of time on, products and services that are shoddy at best. So there's significant room for innovative businesses to provide good-quality offerings with lower overall usage costs and greater convenience than those of present alternatives. The result: a profound effect on productivity.

Before 1997, for example, many people in eastern Manila, in the Philippines, were not connected to the water system and were paying six times the municipal rates to buy low-quality water from informal dealers. Delivery costs drove the high prices: The municipal system was being tapped illegally, and the water was transferred to trucks, passed to intermediaries, and sold door-to-door in jerry cans, leaving it vulnerable to contamination. Manila Water, a private consortium, found ways to connect more people to the city system, reduce the trade in pilfered water, and bring costs down for millions of people. The company benefits economically from the increased volumes being used, but it also has created public value by improving people's access to clean, less expensive water.

Casting the people in the role of consumers is often most appropriate in the low-income segment, where individuals have the greatest resources for making purchases and a business can shape a profitable value proposition on the demand side alone. People in the subsistence segment also have consumer potential, but considerably less of it. (See the exhibit "Which Value-Creation Strategies Work Best at the Base of the Pyramid?")

Coproducers. When a company views base-of-the-pyramid residents as coproducers, it provides them with work and income. A multinational might, for instance, give farmers technical knowledge to upgrade the quality of their output and reward them with greater monetary returns, as Nestlé has done with the sourcing of milk from small dairy farmers in Asia and Mars has done with cocoa farmers in West Africa. With a little training, people at the base of the pyramid can also take part in basic production and assembly jobs or in activities such as transportation, distribution, and retailing—bridging the "last mile" to the customer. For example, Hindustan Unilever has helped to create entrepreneurs by training 50,000 women to go door-to-door educating consumers and selling soap, toothpaste, and other products. These women in turn nourish the local economic ecosystem by borrowing from local banks and microfinance institutions.

Companies may find that engaging people as coproducers is most appropriate in the subsistence segment because earning some additional income is their primary need. With this extra income, they can try to improve the quality of their consumption. However, businesses also can and do engage people in the low-income segment as coproducers—for example, by employing them to make products for consumers who are higher up in the pyramid. Individuals in the extreme-poverty segment are not potential coproducers because they are too difficult to access or don't have the necessary skills.

Clients. A significant portion of the people at the base of the pyramid, primarily in the extreme-poverty segment, are most appropriately treated as clients. The reality is that they need "agents," so to speak, to garner resources on their behalf. The government can serve as an agent, as can a civil society institution, a community organization, or a commercial enterprise. For example, Devi Shetty's advocacy for farmers and other workers in Karnataka, India, engendered the Yeshasvini Health Insurance plan, which started with government subsidies. Patients covered by Yeshasvini are eligible for free care, but bureaucracy and poor management in the public health system too often prevent people from getting acceptable levels of service. The insurer became an advocate for the poor, negotiating for better service from public hospitals. Those hospitals also benefited, by receiving payments from Yeshasvini.

Missteps at the Base of the Pyramid

Numerous companies have blundered by failing to understand the importance of bolstering the success of the base-of-the-pyramid communities where they do business. Too often they assume that their responsibilities end once they have provided a needed product or service, or have engaged people as suppliers or workers.

Companies too often assume that their responsibilities end once they have provided a needed product or service.

That attitude leaves companies vulnerable to criticism. In 2000, when the Bechtel-led water consortium Aguas del Tunari tried to raise water tariffs and collect rents on private wells in Bolivia, all within the purview of its privatization agreement with the local government, violent protests erupted, forcing the company to abandon its business. In essence, it had failed to recognize how people in the region defined success for themselves and, therefore, failed to contribute to that success.

The same trap has ensnared microfinance. The industry is periodically threatened with shutdowns, especially in India, because of outcries over interest rates, even though the average rate charged by Indian microfinance institutions is among the lowest in the world: 25% to 27%. The real problem is that microfinanciers have sometimes appeared to be profiting on the backs of the poor, less because of their interest rates than because of policies that ignore social value. Many microfinance firms assume

Where Private and Public Value Intersect

The Opportunity

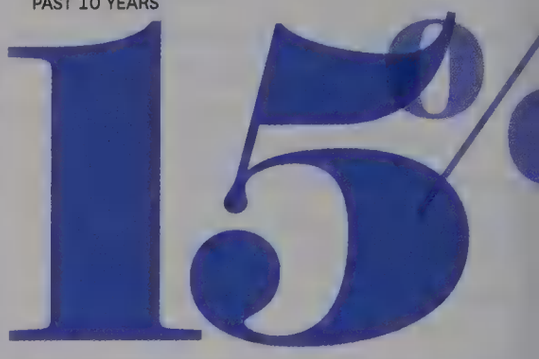
Two decades ago, many of the poor in eastern Manila, the Philippines, were paying six times the municipal rates to buy their water in metal jerry cans from vendors who had illegally tapped into the water system.

The Execution

In 1997 Manila Water, a private consortium, won the concession for providing water. It improved access to clean, less-expensive water and gained consumers' trust by partnering with public authorities, local communities, and contractors. Exclusivity rights and other government guarantees gave the company an incentive to rapidly build infrastructure, if it met certain thresholds for service in poor communities. Manila Water has managed to invest more than $1 billion in capital improvements and to install several thousand miles of its distinctive blue PVC pipes.

The Results

A GREATER THAN 15% RETURN ON EQUITY EACH YEAR FOR THE PAST 10 YEARS



they are doing the poor a service just by offering lower rates than moneylenders do. They appear not to recognize that many of their clients, despite getting loans, have been unable to achieve a higher standard of living. As a result, the companies become scapegoats when customers face tough economic times.

Equitas is one Indian microfinancier that hasn't been targeted. It has shown a commitment to social value by earmarking 5% of its profits for clients' health care, skills development, and children's education, and it has placed a cap on its profits.

In many instances, profits have been so hard to come by in the low-margin environment at the base of the pyramid that companies' commercial initiatives have been quietly absorbed into their CSR efforts. That's what happened with Procter & Gamble's PUR water-purification packets after the company was unable to find a profitable distribution strategy and price. Microsoft's Unlimited Potential program also met that fate. After trying for a few years to eke out a profit by providing refurbished computers, internet cafés, and a scaled-down version of the Windows operating system to developing countries, the company passed some of these initiatives to its corporate citizenship group.

How to Entwine Commercial and Social Value

Many companies have simultaneously created private and public value in part through innovative business models that enlist community members or other organizations in distribution, access, payment, and even security activities. Ensuring that such a model is both commercially feasible and sustainable over the long term involves streamlining operations and designing appropriate incentives for the people who are brought into the economic ecosystems that the companies have created. Let's look at some of these segment by segment.

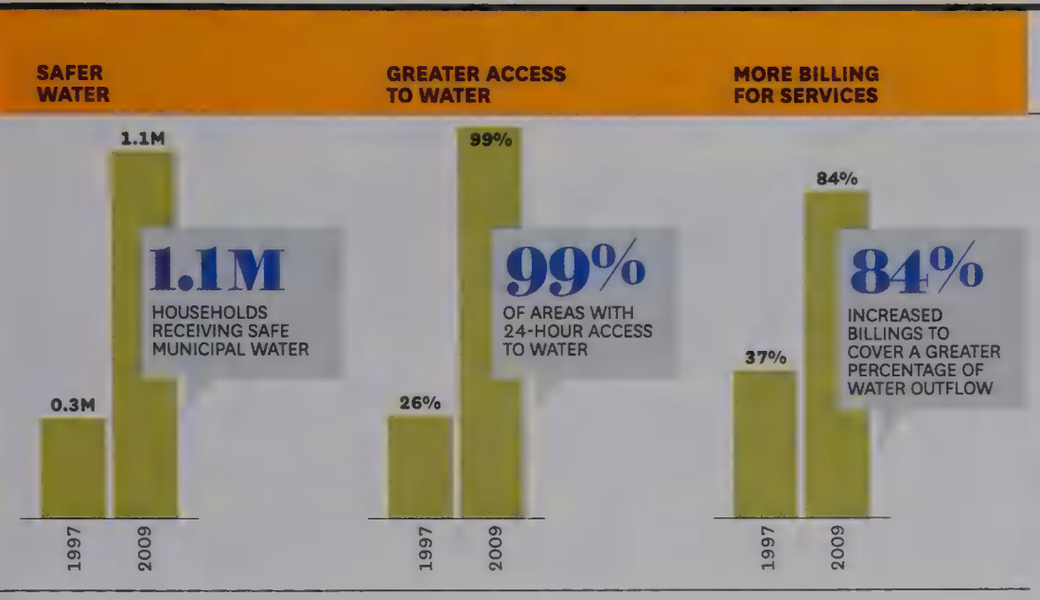
In the low-income segment, examples of innovative, large-scale distribution strategies include M-Pesa's reliance on nearly 18,000 mom-and-pop retail operators to deliver its mobile money-transfer service in Kenya; Novartis's mobilization of more than 20,000 volunteer doctors to visit villages, examine patients, and provide medicines as part of its Arogya Parivar ("healthy family") program in India; and Hindustan Unilever's investment in its army of door-to-door saleswomen. All three strategies depend on the companies' ability to provide incentives and support for the small retailers, doctors, and saleswomen who are integral to the distribution channels and, by extension, to the companies' business models and newly created economic ecosystems.

The California-based biopharmaceuticals manufacturer Gilead Sciences uses an innovative access strategy to produce powerful results. Of the estimated 35 million people with HIV/AIDS in sub-Saharan Africa and South Asia in 2003, nearly 10 million were candidates for antiretroviral drugs. The medications were scarce in developing countries, but not primarily because of affordability—pharmaceutical companies were selling to poor countries at cost. The main stumbling block was a lack of access: Regulations governing registration, licensing, and importation of medicines were limiting availabilty.

Gilead, one of the world's leading suppliers of antiretrovirals, made the patents for two of its top products, Viread and Truvada, available to 12 generic-drug manufacturers in India and South Africa—companies that could have copied the drugs under their governments' licenses to make them affordable to patients. Gilead didn't charge a fee for the technology transfer. It asked only that the manufacturers pay a royalty of 5% of the selling price on the generic versions of Gilead's drugs. These makers were able to produce the drugs much more cheaply than Gilead and to quickly break into markets in Asia and Africa.

Not surprisingly, Gilead's licensing program broke even in 2009, and by 2010 it had generated a $5 million surplus and reached more than 1.4 million patients in low-income countries. In addition, Gilead has helped to create an ecosystem that will

Commercial and social value are like the two blades of a pair of scissors, and scale is like the tailor's deft hand.



aid these countries as they produce and distribute other essential drugs.

In the subsistence segment, people often lack essential information about new products or methods and are reluctant to adopt them. Companies must create demand for entire categories of products. A good example is the water purifier: Hindustan Unilever's Pureit can bring international water-purity standards to millions of homes that have neither running water nor continuous electricity. But many consumers aren't fully aware of the health benefits of purification, and those who are aware have a ready alternative—boiling their water—that seems a lot more affordable than a $22 purifier. As is often the case in the subsistence segment, the access channel must play a role in generating demand. Hindustan Unilever relies on NGOs to both educate consumers and sell its purifiers.

Telecommunications companies such as Safaricom in Africa provide examples of community-based strategies for aggregating millions of small payments. Because consumers lack the cash to buy in bulk or pay a monthly fee, these companies provide airtime for cash up front and sell additional airtime through their networks of agents, usually small retailers. Instead of dealing with millions of consumers with millions of small payments, the companies rely on the agents to aggregate the financial transactions, thereby keeping operations economical and bolstering the economic ecosystem of the small retailers.

The mobile network operator Roshan provides an example of integrating community members into security operations. Before Roshan's founding, in 2003, only about 80,000 of Afghanistan's 34 million people had access to phones. The company established its presence by building eight stores and encouraging Afghans to form distribution networks that supply SIM cards and handsets to other consumers. The network has grown to more than 3,500 outlets, the subscriber base to 3.5 million users, and the pool of people directly or indirectly employed to more than 30,000. Roshan has recruited community leaders to monitor the security of its towers, which the Taliban threatens. The community leaders have multiple incentives to protect the towers: A functioning network provides jobs, training, and security fees. Roshan says this approach has saved it more than $15 million a year.

Other companies, even while selling products and services to customers higher up in the pyramid, create tremendous value by extensively engaging the subsistence segment in their supply chains. Nestlé does it with dairy, Mars with chocolate, and Unilever with cooking and bath oils.

In the extreme-poverty segment, where delivering basic services such as water, sanitation, health care, and education requires heavy investments, companies have little choice but to enter into public-private partnerships that provide guarantees on cost recovery, subsidies, and market exclusivity. Without the partnerships, opportunities for profits are few, even in the long run. Because the needs of the extreme-poverty segment are for the basics (many people consider them fundamental human rights), a company should be careful to earn the community's trust by providing outstanding value, and that value should be the engine of profitability. (See the exhibit "Where Private and Public Value Intersect.")

Businesses also should not overlook the advantages of teaming up with locally established NGOs. The Geneva-based Global Alliance for Improved Nutrition, for example, has worked with some of the world's leading food companies to tackle hunger and malnutrition. Because of a lack of interest from commercial enterprises, GAIN took on the role of venture capitalist, providing seed money to facilitate businesses' development of products and markets for this segment. Among GAIN's partners are Unilever, Cargill, and Akzo Nobel. By providing both financial support and technical expertise, GAIN has ensured that staple grains in China and South Africa are fortified with essential vitamins and minerals. Building on pilot projects financed by GAIN, companies such as Britannia Industries have launched fully commercial product lines as part of their regular businesses.

WE DON'T mean to make this sound easy. The base of the pyramid is a risky place for companies. Indeed, well-meaning, well-financed ones have failed, as Microsoft did with Unlimited Potential. That, unfortunately, has been the fate of many such corporate forays as shareholders become impatient with money-losing ventures. But a strategy of creating private and public value while aiming for scale gives companies their best chance to succeed. Commercial and social value are like the two blades of a pair of scissors, and scale is like the tailor's deft hand. You must have all three elements to slice through the knotty obstacles at the base of the pyramid.

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Faster, Smarter, Efficient: Technology Is Empowering the Next Generation of New Product Development

Driving innovative new products to market is a top priority for companies seeking growth.

But that goal comes with many challenges. The benefits of expanding products must be weighed against an economy still in recovery. Demand for new products and revenues is high; tolerance for inefficiencies and failed experimentation is low. Executives face intense pressure to make the right product decisions quickly.

And the new product development process is becoming more complex, with more people and processes involved from early in the ideation of a product through engineering and manufacturing and beyond to product retirement.

Still, companies are accelerating their commitment to R&D of products over the next two years, according to a new survey of 1,214 business executives from around the world by Harvard Business Review Analytic Services.

Specifically, the survey found:

- More than half the organizations said increasing the rate of innovation is a top priority in the coming year.
- While budgets are tight and increased investments in R&D limited, most companies — 55 percent — are focused on innovation gains that result from increased internal efficiency, such as the expanded use of collaborative software — like Product Lifecycle Management (PLM). More than half said they must adhere to the "fail fast" credo, tightly managing their project portfolios and quickly jettisoning efforts that don't fit.
- The new product development process is becoming more complex, with more people and processes involved. More than half the companies said marketing, operations, sales, and finance work with the R&D department.
- IT is a key enabler of new product development processes and outcomes. IT systems, like PLM, are playing crucial roles tracking compliance with product requirements. These systems manage product data, configuration changes, and workflow requirements, as well as enhance collaboration inside the company.
- Collaboration outside the company is growing. Fifty-five percent said partners are an important new source of innovation, both in identifying new ideas and in innovation support. But this newly expansive approach to innovation has vastly increased the complexity of their R&D process, respondents said, and increased concerns about protection of intellectual property rights.

The survey identified one group of executives who reported better results in managing this innovation complexity with the help of information technology such as PLM. They are using tools to help executives track the ideation process, monitor progress, identify laggard projects, and facilitate collaboration. By capturing knowledge, they are able to reuse it — and their capital — more effectively. These organizations reported better new product development processes and outcomes.

At Siemens PLM Software, we understand that the process of developing products is composed of thousands and thousands of decisions. Some are big milestones on a project timeline, but many more are the decisions that people like designers, engineers, program managers, and procurement specialists make every day. Each has a significant impact on the success of the product. If the right decisions – even the small ones – are reached quickly, the cumulative effect on the overall process can be dramatic. Time is gained. Efficiency goes up. Costs are reduced. Rework is eliminated.

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MANAGING YOURSELF

The Paradox of Excellence

High achievers often undermine their leadership by being afraid to show their limitations.

by Thomas J. DeLong and Sara DeLong



Why is it that so many smart, ambitious professionals are less productive and satisfied than they should or could be? Why do so many of them find their upward trajectories flattening into a plateau? In our experience—Tom's as a business school professor and consultant and Sara's as a psychiatrist—high achievers often let anxiety about their performance compromise their progress. Because they're used to having things come easily to them, they tend to shy away from assignments that will truly test them and require them to learn new skills. They have successful images to preserve, so instead of embracing risk, they hunker down and lock themselves into routines—at the expense of personal growth.

We've seen this time and again with the executives and managers we've counseled—between us, some 600 professionals over a combined 35 years. Many high performers would rather do the wrong thing well than do the right thing poorly. And when they do find themselves in over their head, they're often unwilling

The Curse of Being a High Achiever

Some behaviors that help you succeed can also get in your way. The classic high achiever is:

Driven to get results.
Achievers don't let anything stop them. But they can get so caught up in tasks that providing transparency to colleagues or helping others feels like a waste of valuable time.

A doer.
Achievers believe, often rightly, that nobody can do it as well as they can. That can make them poor delegators—or micromanagers.

Highly motivated.
Achievers take all aspects of their jobs seriously. But that means they often fail to distinguish between the urgent and the merely important.

Craving of positive feedback.
Achievers care intensely about how others view their work—but they tend to ignore positive feedback and obsess over criticism.

Competitive.
An appetite for competition is healthy, but achievers obsessively compare themselves with others, which can lead to a chronic sense of insufficiency, false calibrations, and ultimately career missteps.

Passionate about work.
Intense highs can give way to crippling lows. For achievers, it's a fine line between triumph and agony.

A safe risk taker.
Achievers aren't likely to recklessly bet the company on an risky move, but they may shy away from the unknown.

Guilt-ridden.
Achievers are driven to produce, but no matter how much they accomplish, they feel like they aren't doing enough.

to admit it, even to themselves, and refuse to ask for the help they need.

Consider Ted, a highly successful sales executive at a major enterprise software firm. He excelled at the huge deals that were the revenue engine for the company. He knew the product inside and out, understood the pain points of his customers, and could unerringly sniff out and connect with the real decision maker in a deal. After years of praise and enormous commission checks, Ted began to sense that something was off. The company had expanded in a new direction, shifting to a software-as-a-service business model. Though the majority of revenue was still coming from the legacy products, all the innovation and energy were focused on the subscription offerings. At first, Ted was contemptuous—selling software as a service was all about small transactions and high volume. "Just get some telemarketers for that nickel-and-dime stuff," he'd say. "I'll handle the big boys." Soon, though, he began to see the writing on the wall: He was becoming increasingly marginalized in the company—and in the industry. But he was paralyzed by fear and self-doubt. His professional identity and self-esteem were wrapped up in his success as a salesman.

Consider, too, Kurt, a lawyer known for his trial skills and intellectual heft; he was a natural in the courtroom and a skilled writer with a keen sense of nuance. When he was assigned a case that required combing through thousands of technical documents, he believed it would just be a matter of rolling up his sleeves and getting to work. But early on, he realized he didn't have enough content expertise and couldn't make sense of the casework his associates delivered. He began to find himself alone in his office, late at night and on weekends, wading through and deciphering the facts. It wasn't until almost the eve of a trial that Kurt finally asked for help—which didn't endear him to colleagues who suddenly found themselves joining him in the office after hours.

Of course, leaders within organizations bear some of the blame for this mind-set. They don't always want to hear that somebody's struggling, nor do they necessarily reward new ways of doing things, despite the lip service they might pay to innovation and prudent risk taking. As one executive we worked with pointed out, "My boss wants innovation as long as it's done perfectly the first time." Another confided, "We tell our people over and over again that we will support their professional development, but if a new project doesn't work out immediately, we basically push them over the cliff."

However, it's possible to break this cycle and make the next move toward professional growth. First, you have to take a hard look at yourself and identify the forces that escalate your anxieties and cause you to turn to unproductive behaviors for relief. (See the sidebar, "The Curse of Being a High Achiever.") Then you must adopt counterintuitive practices that give you the courage to step out of your comfort zone. This won't happen overnight. It requires acknowledging vulnerability, something that driven professionals don't like to do and that runs counter to their obsession with managing their image at all costs.

To achieve continued success, you must open yourself up to new learning experiences that may make you feel uncertain at best and incompetent at worst. Remember that those feelings are temporary and a prelude to greater professional ability.

Let's look at steps you can take to get past self-imposed limitations.

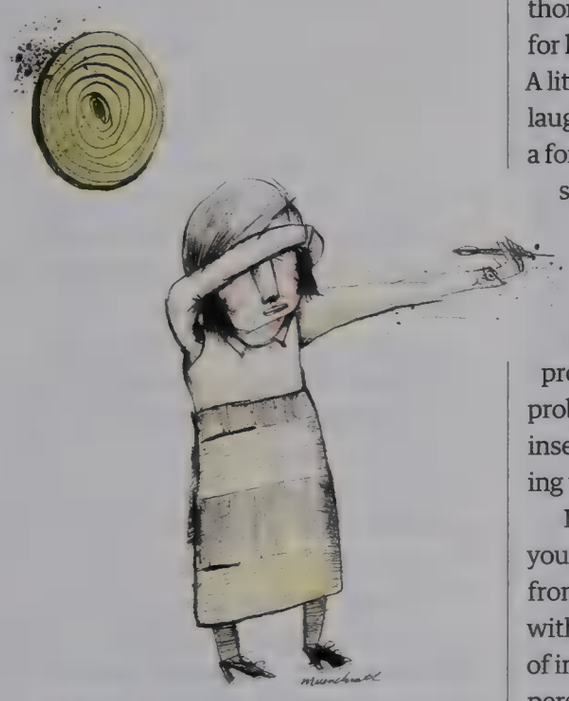
Put the Past Behind You

No doubt you've had negative experiences when it comes to taking on new challenges. Research shows—and our experience bears out—that most of us tend to make irrational comparisons between a past bad experience and a current situation. But painful memories don't have to remain obstacles to change.

One exercise we use successfully with our clients can help you distinguish between reality and perception, with regard to both your own past behavior and the way your organization responds to honesty and risk taking. Think about a time when you tried something new and were disappointed with the result. Why did you take the assignment on? Why did you struggle? Did you ask for help? Did

your perception of your performance match that of your colleagues? Knowing what you know now, what would you have done differently? Write down in two columns the similarities and the differences between a risk you are currently contemplating and that past negative experience. Identifying the key differences will make it easier to move forward.

Or, think of a risk you took that went badly and rewrite the story from another person's perspective. Let's say you obsess about a longtime customer who signed on for an engagement from your firm's fledgling consulting division but then suddenly backed off and switched his business to a competitor. He's a liar and a jerk; he made a fool of you. Now put yourself in his shoes and retell the story: Maybe his boss made some unexpected demands or his company had to revisit cost or feature trade-offs. You don't have to believe that version, but acknowledging that a credible alternative perspective exists is a reminder that it's not just about you.



Almost without exception, overwhelming feelings of inadequacy are in our own minds.

Another simple but surprisingly effective strategy is to write down what happened in a difficult interpersonal interaction—one page should suffice—and then read it over, underlining just the facts. You will find that there are only a handful of underlined phrases—the rest is pure interpretation. The point is that when you shift the way you view a painful interaction, you can begin to put the past behind you.

This approach helped Joanna, a marketing manager at an international spirits company. Her particular talent was in creating sophisticated branding campaigns to appeal to big high-end retailers. When the company started selling directly to consumers over the web, an entirely new skill set was required. At first she dug in: She insisted that her marketing approaches would be just as successful online and refused to ask for help. She was faltering badly until she forced herself to think hard about why she was so afraid to adapt to the new medium. She thought back to her first job as an assistant at a publishing company. She had volunteered a risky idea for an author promotion, and the president, known for her temper, had thrown a pencil at her. A little older and a little wiser, Joanna could laugh at the story. But it was nonetheless a formative experience, and for years it subtly influenced her behavior at work.

Upon reflection, Joanna realized that the incident was not about her poor judgment or misguided risk taking—it was about her erstwhile boss's unprofessional behavior. The president was probably taking out her own deep-seated insecurities on Joanna, an easy target owing to her youth and inexperience.

It's hard to exorcise past demons until you've looked at them dispassionately from multiple points of view. Almost without exception, overwhelming feelings of inadequacy are in our own minds. Our personal disasters are but tiny specks when it comes to other people's reality.

Once Joanna realized how that long-ago episode had been holding her back, she challenged herself to volunteer for a task force exploring new channel

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opportunities. She also got up the nerve to ask a colleague to serve as a sounding board. The aim was not just to test the viability of her ideas but to bolster her courage. What began as a fairly stressful career-booster turned into a productive monthly dinner. In the end, Joanna moved on to a senior position at a global cosmetics company as the vice president for duty-free promotions. She surrounded herself with a team of smart, reasonable people and resolved never to let her own fears get in the way of embracing new ideas.

Use Your Support Network

High achievers are, as a rule, very independent and don't like to think they need a lot of help. Even those who have been lucky enough to have good mentors think they've won them by being excellent contributors. As they rise to the senior level and become mentors themselves, they often become even more reluctant to confess to fear, confusion, or incompetence. Making matters worse, they confide in people who tell them what they want to hear, not what they need to hear.

A case in point is Catherine, a manager at a rapidly growing software firm, who was accustomed to having the high regard of her executive team. After a few years on the job, she found herself in charge of a presentation that included an overview of a project run by her previous boss, who was now in a more senior role. She put off her review of his slides because she was worried she wouldn't be able to deliver the content as well as he would have. She was terrified of sounding stupid or embarrassing herself in front of somebody she truly respected. She kept procrastinating until the night before the presentation, when she finally reviewed the content and sent him an e-mail with some very cautious inquiries. He surprised her by answering her questions without defensiveness and offering suggestions for improving the presentation. Catherine felt as though a weight had been lifted from her shoulders. She realized how silly she'd been not to ask for his feedback sooner.

Long-term goals can withstand minor setbacks, so look at the big picture and give yourself the latitude to make some missteps along the way.

Many high achievers avoid other people's opinions when they fear their work is not up to par. That kind of behavior is self-destructive. Challenge yourself to develop a support network and then regularly ask individuals to give you honest feedback, even if the process is painful. Ask key people to engage in what a former professor of mine, Phil Daniels, calls an SKS. It's a process where you ask others what you should *stop* doing, what you should *keep* doing, and what you should *start* doing.

When you review the answers, consider—or better yet ask—why people might suggest that you stop a behavior (it could even be a behavior you view as a strength). Think about whether you've been dismissive of certain skills or behaviors because they come easily to you. Consider why people may have suggested that you acquire other skills.

Become Vulnerable

Practice acknowledging uncertainty or confessing mistakes with people who are close to you or about projects that aren't central to your professional identity. Admit to small failures—without rattling off a litany of extenuating circumstances. Consider another executive, who had joined the board of a local nonprofit. He believed in the cause and wanted to give back to his community. But realistically, with his day job, his children at home, and his wife also working full time, he didn't have the bandwidth to keep up. He skipped board meetings, making excuses, and avoided duties that would expose his inability to fulfill his obligations. The commitment became, for him, a source of deep embarrassment.

He suffered quietly for nine months before telling his wife of 20 years that he thought he couldn't do the job. Even then, he felt humiliated and was reluctant to admit that he'd bitten off more than he could chew.

But it turned out that just voicing his anxiety brought him a surprising degree of relief. He shared the same story with several close friends, and after a few days he decided to resign his directorship. He told the board quite simply that he'd taken on too many responsibilities and that, although he would still help with individual fundraising events, he could no longer commit to full board membership. His fellow members, who were by no means unaware of his struggle to keep up, were actually pleased to come to some closure and genuinely appreciated his commitment to contribute in a way that was manageable. Because of his honesty, his relationship with the board improved.

Consider, too, Anne, an executive who called in an analyst to demonstrate a sophisticated modeling approach to improve forecasting at her company. The analyst plunged into the material, using highly technical jargon to explain the model. Anne was reluctant to admit that she couldn't follow the presentation, but swallowing her pride, she interrupted, saying, "I'm sorry—this is not a comfortable area for me—could you explain those terms and go a bit slower?" The analyst began to speak in clearer terms, and in doing so, some faulty assumptions came to the surface. The meeting took on a much more collaborative tone, and both left with a better understanding of the challenges facing the company.

Often the failure to admit vulnerability can have devastating consequences. Arguably, the recent financial crisis was exacerbated by the fact that some leaders were embarrassed to acknowledge that they did not understand the financial products they were selling. Things might have gone differently if somebody had had the courage to raise a hand and say, "I'm not getting this—could you please explain again the product you've created?"

CONNECT WITH THE AUTHORS Do you have questions or comments about this article? The authors will respond to reader feedback at **hbr.org**.

Another way to practice vulnerability is to deliberately put yourself in situations where you literally know nothing. Take a language class unrelated to your heritage. Join a book group where you can't control the selections—and force yourself to speak up at every meeting.

Most likely, your colleagues and acquaintances are also high achievers who hold back from sharing their concerns. When you take the bold step of being vulnerable, you send a powerful message to those around you that invites them to do the same.

Focus on the Long Term

Major goals can withstand interim setbacks. When you are looking at the big picture, you often give yourself more latitude to make a few missteps. One lawyer with a passion for civil liberties, Steven, told us of an experience writing a brief that was in an area of law that lay outside his experience. He was paralyzed by the prospect of looking incompetent to the members of the legal community he admired most. That the subject matter was only slightly out of his area of expertise made it all the more daunting—he felt he should know instinctively how to respond.

Steven realized that he had to grant himself the permission to be mediocre—an appalling prospect for achievers. He weighed the possible consequences of a subpar brief against the broader benefits of expanding his expertise and making an influential contribution to the case. As it turned out, his work on the brief garnered him additional respect from his colleagues. It was a solid effort that demonstrated his ability to stretch beyond his comfort zone.

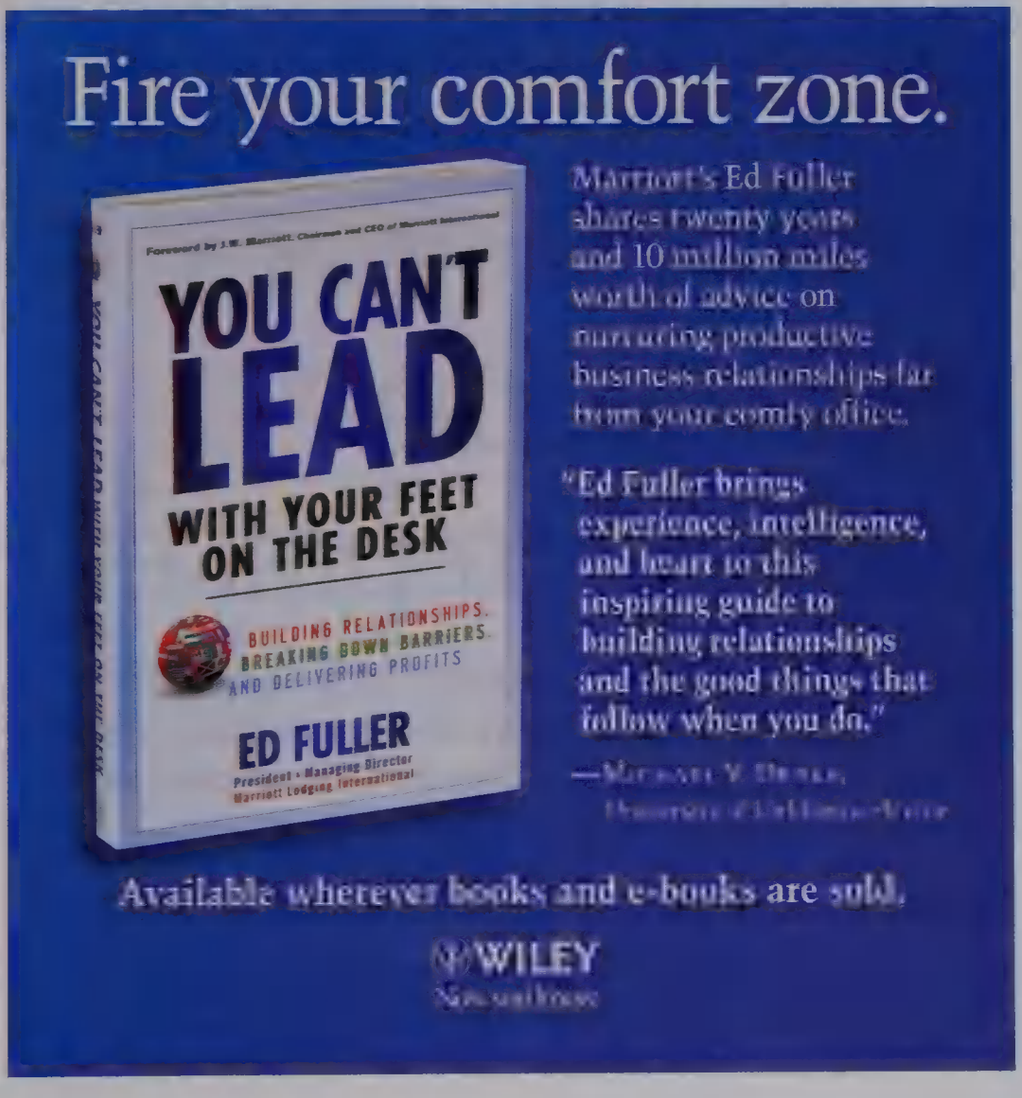
Long-term success requires some willingness to commit to necessary short-term risks. High achievers often let their fear of failure stop them from taking those chances. That was the case with Rick, a respected professor but a dismal team player. His students loved him, but his peers were increasingly vocal about his refusal to contribute at an organizational level. He couldn't be counted on to complete any work other than what was on his own to-do list. Rick consciously ignored his colleagues' feedback, in part because he knew he was less talented at organizational tasks. Mostly, though, he was just too self-absorbed to pay attention to anything other than his own teaching, research, and publishing agenda. Unfortunately, Rick's inability to see the big picture was his undoing, and his contract was not renewed.

In his next position, Rick resolved to do things differently. He invested time and effort in shoring up his organizational abilities. Though he worried initially about not focusing his all energies on teaching, his farsightedness paid off: He's now one of the most highly regarded professors in his department—on all counts. He still feels anxiety about his weaknesses—that's who he is—and in a way it's what makes him great. He's never satisfied.

DOING THE right thing poorly is painful for high achievers. It's much more satisfying to do something well, even if it's not the best use of your time. Moving your A game to a new level or in a new direction takes humility, it takes practice, and it takes patience (not necessarily your strong suit). But it's a necessary step on the road to doing the right thing well.

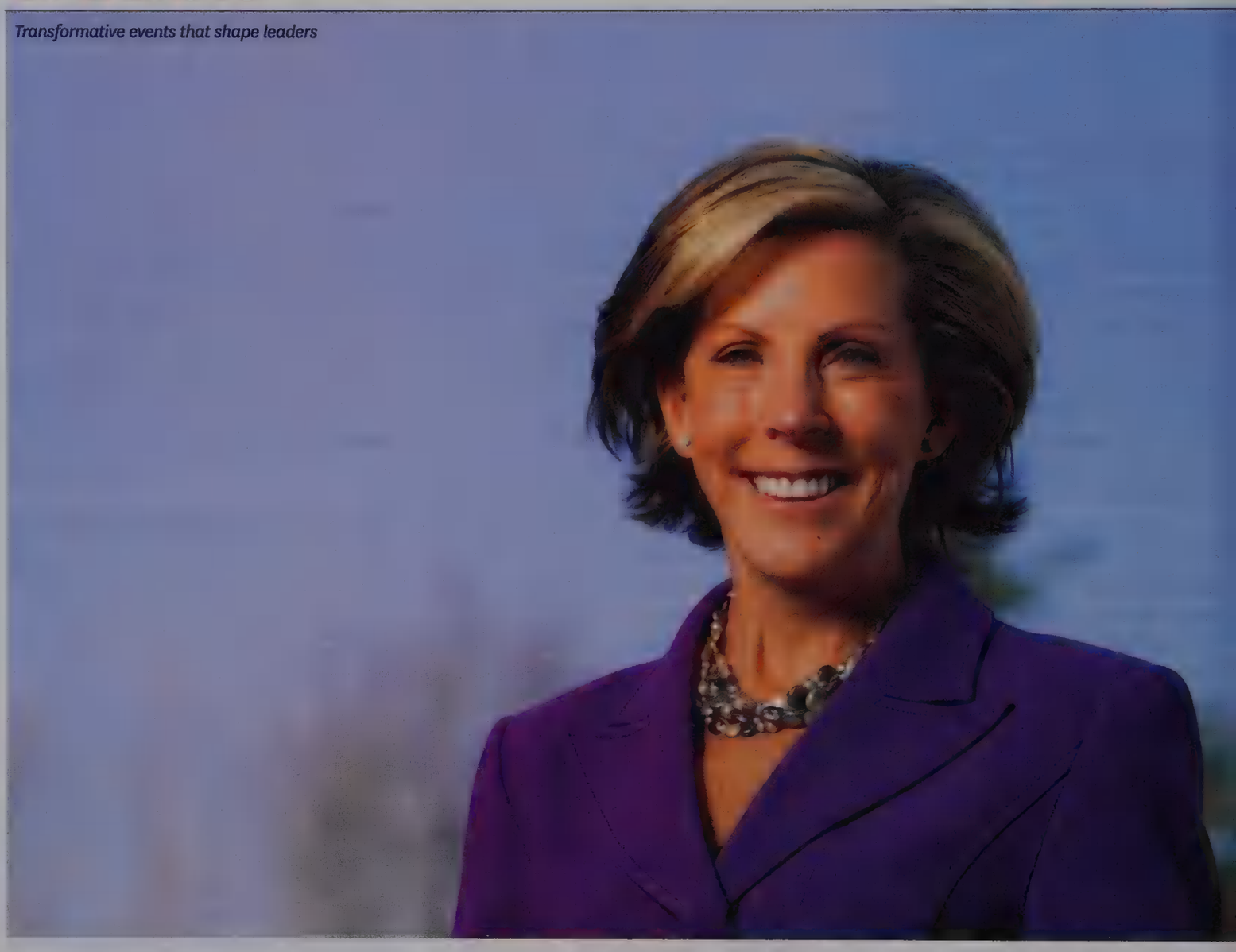
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Crucible

Transformative events that shape leaders



The Reluctant Social Entrepreneur

Kathy Giusti was a rising star at Searle when cancer forced her to leave the corporate life she loved. Even she was surprised by her next move.

by Steven Prokesch

Kathy Giusti never had any desire to be an entrepreneur—especially one in the nonprofit sector. She loved working for a big corporation and didn't see herself as a risk taker. In early 1996 she was on the fast track at the pharmaceutical company G.D. Searle and aspiring to be one of the first women on the executive committee when, at the age of 37, she got news that would change her life: She had multiple myeloma, a deadly blood cancer.

The diagnosis led her to start the Multiple Myeloma Research Foundation and the Multiple Myeloma Research Consortium, two organizations based in Norwalk, Connecticut, that have won kudos for helping accelerate the development of treatments for the disease. Both have become models for running medical-research nonprofits in a highly disciplined way. The lessons

from Giusti's story—how she adapted to her new world, constantly adjusted her strategy, and persuaded institutions set in their ways to change—are valuable for anyone contemplating moving from the private to the public sector or abandoning corporate life to become an entrepreneur.

Until 1996, Giusti's career had been zipping along. She'd been a premed at the University of Vermont but after graduation decided to pursue a career in the pharmaceutical industry rather than go to medical school. She became a sales rep at Merck, where she was identified as a high-potential employee. She left to attend Harvard Business School and then went to work for Gillette in Boston. When she married Paul Giusti, an HBS classmate, she moved to Chicago and took a marketing job at Searle.

She quickly attracted management's attention. "It was obvious from an early point that she was pretty special," says Alan Heller, who was Searle's copresident. He describes her as "highly intelligent, highly analytical, and very driven." Other current and former colleagues call her a perfectionist. She played an instrumental role in the launches of two successful drugs: Ambien, the sleep medication, and Daypro, an arthritis drug. She also impressed her bosses by mastering other jobs, including running a sales region—the position she held when she learned she had myeloma.

She and her husband had an 18-month-old daughter and had been trying to conceive a second child. Doctors she consulted found the cancerous plasma cells. She was told that myeloma patients were living, on average, three or four years. There was no cure. "They said, 'You just need to get your life in order,'" she recalls.

Determined not to leave her daughter, Nicole, an only child, Giusti underwent in vitro fertilization. After becoming pregnant with her son, David, she left her job and moved with her family to Connecticut to be close to her twin sister and her in-laws. "I was heartbroken to leave Searle," she admits. "I loved what I did. But when you're told you're going to die, your first instinct is not to worry about your job. Your first instinct is to worry about your family."

Bringing Rigor to Nonprofits

Giusti extensively researched the treatments for myeloma. She was shaken by what she learned. The drugs used to combat the cancer dated back to the 1960s, and no one was devoting significant R&D resources to it. Myeloma is what is known as an orphan disease. Relatively few people (currently, about 60,000 in the United States) have it. And with the development of a new drug costing more than $1 billion, on average, drug companies prefer to focus on illnesses affecting much larger populations. Having worked in the industry, Giusti understood that. "I'm thinking to myself, 'What pharmaceutical company is going to want to do this?'" she says.

Giusti was told that myeloma patients were living three or four years, on average. There was no cure. "They said, 'Get your life in order,'" she recalls.

When people began donating money to help her, Giusti decided to use it to promote myeloma research at medical centers. "I thought that if we funded research, maybe there'll be something that comes along that will buy me a little more time—at least long enough that my daughter would remember me," she says.

She joined the board of the existing nonprofit for the disease, the International Myeloma Foundation. But its main focus was providing information and support. So, along with her twin sister, Karen Andrews, Giusti founded the Multiple Myeloma Research Foundation in 1998, to raise funds for research and attract more people at academic medical centers to the field.

She confesses that she hadn't had much respect for nonprofits, because she thought most were not professionally managed. "I wanted people to see that I wasn't going to run some schlocky nonprofit. I was going to try to do this right," she says.

That was hardly easy for a self-described "big-company person" who was accustomed to being surrounded by talent and being able to call on whatever support she might need. "The day I start, I'm at a computer in my house, trying to make decisions," she remembers. "I don't have an HR department. I don't have an IT person to call. It was a disaster."

But she quickly realized that she had a powerful personal network that she could tap, including her sister, then a lawyer at Time Inc.; Heller, her boss and mentor at Searle; and her Harvard Business School classmates. An HBS alumni group helped her create her first business plan.

From the beginning, she has insisted that the foundation (and later the research consortium) have detailed strategies and implement them with discipline. Its current strategic plan for personalized medicine runs 67 pages and lays out nine strategies and 22 programs. The leaders of its 24-member staff hold a strategy meeting every Monday and an operations meeting every Tuesday. Giusti requires the foundation and the consortium to use metrics, benchmarking, and scorecards so that all parties know their individual and collective performance and strive to do better. "Kathy was selling ROI to donors two years into the foundation," says W. Dana LaForge, chairman of the foundation's board and a partner at a private equity firm. Giusti's approach has helped her attract and retain talent from industry, such as Louise Perkins, the foundation's chief scientific officer, who spent 16 years at pharmaceutical companies. "What

was clear from the moment I walked in the door was that this place operated in a way you wouldn't expect of a nonprofit," Perkins says.

Collaborating to Conquer New Challenges

To date, Giusti has raised more than $165 million for myeloma research—an extraordinary achievement given that the vast majority of U.S. nonprofits never break the $1 million mark. What makes it even more impressive is that she is an introvert by nature. "She's not someone who is really comfortable in the limelight," says Scott Santarella, CEO of the Bonnie J. Addario Lung Cancer Foundation and former COO of the foundation and the consortium. When Giusti is preparing a speech for a gala event, she puts at least 100 hours into rewriting and rehearsing it, he adds.

Fortuitously, shortly after Giusti launched the foundation, thalidomide, a drug used to treat leprosy (and famous for causing birth defects in the late 1950s and early 1960s, when it was prescribed as a sedative, a painkiller, and an antidote to morning sickness), was discovered to have an impact on myeloma tumors. A couple of years later, a new proteasome inhibitor proved effective. Interest in myeloma among academic researchers and biotech and pharmaceutical companies grew substantially. But Giusti then saw that competition among the scientists and clinicians was becoming a major obstacle to drug discovery and development. She realized that the only way to get these players to collaborate was to form a community to which they felt they had to belong—one that allowed them to do things that they couldn't on their own.

Toward that end, she forged close relationships with myeloma experts who shared her vision at four prestigious institutions—the Dana-Farber Cancer Institute, the Mayo Clinic Cancer Center, the H. Lee Moffitt Cancer Center & Research Institute, and Princess Margaret Hospital. Together, they drew up a plan for a research consortium and persuaded their institutions to join it.

The centers agreed to publish their research findings together, set benchmarks and metrics for conducting phase I and II clinical trials, pool data, and build a state-of-the-art bone-marrow and blood-cell bank that researchers could tap. In addition, the consortium—whose membership has grown to 16 medical centers and community hospitals—conducts clinical trials of promising drugs in companies' pipelines. The foundation's database of myeloma patients makes it easier to recruit patients for the trials and helps the consortium attract pharmaceutical and biotech firms seeking to run them.

Though most nonprofits never break the $1 million mark, Giusti has raised $165 million for myeloma research.

"What Kathy brought to the table was an unwillingness to accept the norm," says Keith Stewart, dean for research at the Mayo Clinic in Arizona. "She's a demanding person. She knows what she wants, and she doesn't rest until she's found a solution to thorny problems."

There are now four FDA-approved drugs for treating myeloma, and six more are in phase III clinical trials. Giusti's organizations played a role in almost all of them. The average life expectancy for people with the disease has doubled to seven years.

Though myeloma eventually kills everyone who has it, the newest hope is that genomics and personalized medicine will produce breakthroughs. In typical fashion, Giusti has plunged into systematically learning not only the science but also who the best potential partners are. She has enlisted the Broad Institute and the Translational Genomics Research Institute to sequence the myeloma genome. One discovery: There are a number of kinds of myeloma.

Giusti learned that she had one of the deadliest varieties. Her disease, which had been asymptomatic at first, became active in 2005. After drugs proved ineffective, she underwent a successful stem-cell transplant from her sister in 2006 and remains in remission. "One of the legacies of the transplant is she is susceptible to bugs," her husband says. "I think people sometimes don't recognize how hard it's been to do what she's done."

Giusti regularly works 12-hour days and every weekend. She has taken only three months off, when she had the transplant. "That's just part of being an entrepreneur, right?" she says.

By all accounts, she holds herself and her employees to extremely high standards. Her litmus test for both staff and partners is their dedication to helping patients and their drive and ability to produce results. (All job applicants are put through a personality assessment.) "She's not a touchy-feely manager," her sister says. "It's not her style. To work in an incredibly winning organization and to be treated with respect is what she looks for and what she expects her employees to look for."

Giusti admits that she had trouble believing that people who didn't have myeloma could share her sense of urgency. "But I have learned that there are people equally as passionate as I am about finding a cure," she says. "They may be passionate in a different way, but they want to get it done. Those are the people I trust."

Can she trust someone enough to let him or her take over her organizations? Clearly, this is a big challenge for her. Giusti, who is 52, recognizes that succession planning is important. "I know I can't do this forever," she says. "I know a relapse is inevitable." But those close to her have trouble imagining her handing over the reins completely, because there is still no cure for her disease.

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Steven Prokesch is a senior editor at *Harvard Business Review.*

"The Questions Don't Change, but the Answers Do"

How the Cloud Makes the Future Real

How can the intersection of devices with the cloud create opportunities for individuals and businesses?

Today, most of us own hundreds of computers, from PCs and smartphones to devices in our cars, home appliances, and entertainment systems, and we interact with thousands of others embedded in society's everyday supporting infrastructure, from health monitors to traffic sensors. We predict the number of devices will soon exceed 50 billion, most connected to the Internet, communicating device-to-device, device-to-cloud, and cloud-to-device.

This connected world and our electronically mediated interactions with it are creating a torrent of digital data that challenges historical approaches to knowledge management and preservation. But with challenge comes opportunity. While in transit, I can use my smartphone to connect to Bing and ask a question. With the location from the smartphone's GPS, speech-to-text translation, and location-specific data, Bing can return an answer — the nearest movie theater is four blocks away; click here for directions and to purchase a ticket.

In a future world of plug-in hybrid cars, your smartphone and the cloud will cooperate with your car. The appointments in your smartphone's calendar, together with traffic data and your car's continuously monitored energy usage, will allow the cloud to plan your driving route and charging plan, even alerting the utility as to the expected energy load from all cars being charged.

This isn't science fiction. As part of Microsoft's partnership with Toyota, we're building a global platform for next-generation services, fusing telecommunications and information technologies in cars, atop the Windows Azure Cloud Platform.

In research, new instruments, from telescopes to genetic sequencers, are producing more data weekly than scientists once captured in a lifetime. Cloud storage and computation, coupled with cloud-enabled tools like Excel DataScope, are enabling researchers to respond in minutes to questions that were once impossible to answer.

Further, the cloud can support multiparty, neutral collaborations among experts scattered globally. To develop drugs targeted at individuals, not broad populations, the expertise of pharmaceutical companies, academics, and government must be fused. This raises many issues — extracting relevant data, correlating concepts, bridging cultural and technological divides, and alleviating competitive concerns. The cloud allows diverse parties to collaborate and access data in neutral ways with their own tools.

How can the cloud help businesses of all sizes — especially in these tough economic times?

Today, an Internet presence is not a luxury but a necessity for every business. Before the cloud, a small company could create an Internet presence only by building IT infrastructure. With cloud business and services, a startup can have the same high-quality infrastructure as a multinational company and pay based only on usage.

Cloud services can also scale dynamically in minutes to respond to rising demand, allowing companies of all sizes to be nimble without large capital costs. Moreover, by reducing IT infrastructure, the cloud enables companies to focus on their core competencies, rather than on IT.

How should we think about the way the cloud compares to existing IT infrastructure?

I like to say the questions don't change but the answers do. How do I maximize return on investment? What are the disruptive economic and technological forces? How can I remain nimble? The business questions are the same for any young entrepreneur or seasoned CEO.

In computing, though, the answers always change, for the costs, capacities, and speeds of technologies can shift by orders of magnitude. Today's smartphone is yesterday's supercomputer, and yesterday's national archive is someone's digital music collection.

These shifts have transformed computing, bringing a plethora of smart personal devices. In turn, inexpensive storage, powerful computing, and high-speed broadband have enabled the creation of cloud services for businesses, governments, and consumers.

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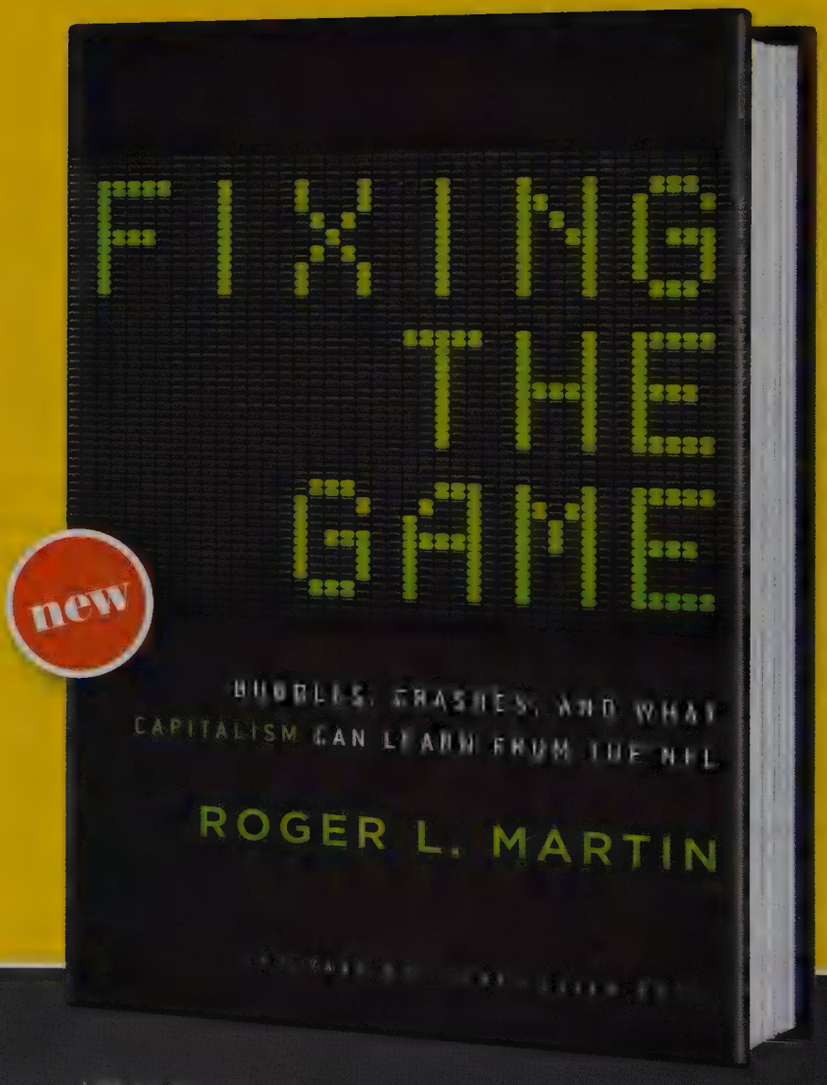
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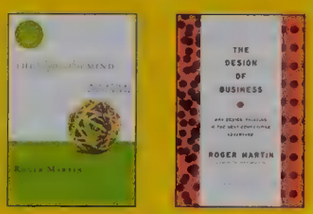
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Case Study

Alegre Hotels has traditionally left promotion to each of its diverse properties. But a looming crisis may call for a new strategy.

by Marco Bertini and John T. Gourville

Time for A Unified Campaign?

The Experts



Raúl González is the CEO of Barceló Hotels & Resorts for Europe, the Middle East, and Africa.



Kevin Lane Keller is the E.B. Osborn Professor of Marketing at Dartmouth's Tuck School of Business.

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "Barceló Hotels and Resorts" (case no. 511108), by John T. Gourville and Marco Bertini. It is available at **hbr.org**.

"Welcome, welcome." Beatriz Soto greeted Fernando Ruiz, the COO of Alegre Hotels, as he stepped out of his taxi into the Cozumel sunshine. He smiled, extended a hand, and kissed her on both cheeks. "Palma Cay's first month," he said. "How is it going?"

"Operationally, very smoothly," Beatriz replied. They walked into the luxurious lobby. "A few electrical issues in the spa and conference center, but nothing to worry about."

Fernando's eyes moved quickly from the marble floors to the skylights, the mahogany reception desk, and the glass doors framing the infinity pool and the ocean beyond. In one corner of the lobby, two women sat under a potted palm, sipping sangria while children played at their feet. In another, a concierge watched a scuba-diving video with a man and his teenage son. The hotel looked fabulous—five-star, just as they'd intended.

"Have the bookings picked up?" Fernando asked.

"Honestly, not much," Beatriz said. "Can we step into my office to talk before we do the walk-around?

She led him down a long corridor to a door marked "Hotel Manager." Beyond it was a small room with a partial view of the elaborate garden. Beatriz picked up some papers from her desk—a memorandum on Palma Cay letterhead clipped to several Excel spreadsheets.

"I know this hotel made a lot of sense in 2007, when Alegre broke ground," she began. "And I think it still makes sense. The economy's got to come back to full strength sometime. But our bookings for the high season are looking terrible. I'll be lucky to fill half our 1,000 rooms."

Fernando knew that bookings had been slow, but he'd hoped for better news. Beatriz went on: "You know my track record. I've handled tough times before. Palma Cay is Alegre's new flagship, and I

think I can make it work by lowering prices for the key travel agencies, tour operators, and online portals. But I can't do that within my current budget. I need help."

"What sort of help?" he said.

"Give me $700,000 from corporate funds. I'll put together a plan to get this hotel on track."

"Beatriz, you know how Alegre works. You're responsible for your own P&L, just like all the other hotel managers, and that includes promotional spending of any kind. In fact, we barely have a marketing budget at the corporate level. How could I justify giving what little there is to one hotel when plenty of others are struggling, too? Mexico City, Cancún, Caracas—bookings are down everywhere. Pretty soon everyone would be asking for special funds."

"But my capacity is double that of Alegre's next-largest hotel. And this is our flagship property now. Our newest luxury resort. I can just see the headlines if Palma Cay is empty the first winter: 'Alegre's Latest Gamble Falls Flat.' We might never recover."

"So make sure that doesn't happen."

"I want to—but I need help. Please just look at my proposal."

"Of course I'll consider it." He was tempted to tell her about the idea he'd been mulling over—a corporate-level promotional campaign—but thought better of it. "Now let's see the conference center. What were the electrical issues?"

Distinct Personalities

Fernando sat in the airport thinking about Palma Cay. After three years and $500 million in development costs, it was a gorgeous hotel, the best designed and best located in the company's portfolio. Its success was critical to Alegre's health—his CEO, Carmen Fiera, had made that clear. But the tour operators and travel agencies that Alegre had always relied on to fill rooms were having trouble selling any resorts, and bookings were particularly slow for Palma Cay.

Beatriz clearly believed she could fix the problem. Fernando trusted her intuition and thought that her plan had merit. Since 2001, when she'd arrived at the company, she'd turned around two hotels. The first was an aging beach property that had struggled during the winter months. Beatriz had noticed how many amateur and professional athletes were doing off-season training in the area and decided to court them by investing what money she had in a state-of-the-art fitness center. Now the hotel was nearly always fully booked. The second was a city hotel that she'd transformed from fusty to hip simply by hiring an inexpensive decorator to make it over, opening a new restaurant that attracted a night and weekend crowd, and targeting youth-friendly travel operators.

> "I can just see the headlines if Palma Cay is empty the first winter: 'Alegre's Latest Gamble Falls Flat.'"

But Fernando couldn't help thinking that the slow start at Palma Cay was symptomatic of a much broader problem—one that would require a bigger solution. Alegre was the third-largest hotel group in Latin America, with 206 popular, high-end properties in cities and resort towns from the Caribbean to Argentina. Yet few travelers thought of their hotel as an "Alegre hotel," as they might think of a Marriott or a Four Seasons, because the company had always preferred to emphasize the distinct personalities of its properties, each of which was tailored to its locale. Operations were highly decentralized: Each hotel retained its own identity, managed its own business with full profit-and-loss responsibility, ran its own incentive programs, and handled its relationships with key intermediaries. The benefit was diversity (if the family-friendly beach properties weren't performing, the boutique urban hotels or inland golf retreats could pick up the slack) and flexibility (local staffs could tweak operations to suit their circumstances). The downside was that guests might return again and again to one hotel yet be completely unaware of the larger Alegre family. The company had no way to stimulate demand across its portfolio; it didn't even have a loyalty rewards program, which was now standard practice in the industry. In a year when forecasters were predicting a decline of 20% to 30% in hotel occupancy, that was a big competitive disadvantage.

Since he'd been recruited to the company, in 2008, Fernando had thought about changing this. Now, given the dire situation at Palma Cay, he might have the ammunition to do it. The executive committee would probably agree to invest in a local price promotion to boost the hotel's fortunes. But should the company instead spend that money on a broader, more daring initiative? Should it take this as an opportunity to launch its first-ever portfolio-wide campaign directed at consumers—a branded price promotion paid for with corporate resources and contributions from all the individual hotels?

The ringtone of his BlackBerry interrupted his train of thought. It was Hans Edelman, a Dutchman who managed Alegre's most profitable hotel, in Buenos Aires. "Hello, Hans," he said.

"Fernando, hi. I just wanted to confirm that you're still planning to visit next week. One of our regular guests has requested the suite you usually stay in. May I move you to the fifth floor instead?"

"Of course, of course."

"Excellent. While I have you on the phone, may I speak to you about something else?"

"Sure."

"I understand that Palma Cay has requested some extra promotional funds and that you're considering it."

Hans had worked for 12 years with Beatriz's current deputy, mentoring him up through the ranks at Alegre, and the two men were still close. Fernando assumed that was how the information had traveled so quickly. "Yes," he said.



SOLUTION
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"I also understand that you're considering a corporate campaign with significant discounts for guests."

This time the source must have been Ana Montoya, the company's chief marketing officer. Fernando had briefly floated the idea past her the previous week, just before she went to Buenos Aires. "Again, yes," he said.

"With all due respect, I would be unhappy with either option, and I know many other managers would also feel that way. We're all dealing with the same economy, and some of us are faring better than others. You'd be taking from the rich hotels to give to the poor ones. And you can't advertise an upscale urban hotel like mine in the same breath as the family resorts, with their children's pools and gourmet pizza parties. It would completely undermine what we've created here."

Fernando had always appreciated Hans's direct style, but this was pushing it. "Hans, it's not your decision."

"Of course it isn't. I apologize. But all the top hotel managers at Alegre chose to work here because of the autonomy—the opportunity to manage a unique property and make it their own. That's why we stay." Hans had rejected an offer from a major global hotel chain the previous month, as Fernando knew. "I thought you'd want that input."

"I appreciate that, Hans. I'll take it under advisement. And I'll see you next week."

"Yes, sir."

Fernando was annoyed—not with Hans (his reaction was to be expected) but with Ana, for mentioning the possibility of a corporate promotion before the idea was fully formed. He was about to call her when he heard the boarding announcement for his flight. By the time he was settled in his seat, he had calmed down. He would wait to talk to her in person.

An Uphill Battle

Ana knocked softly on Fernando's office door. "You wanted to see me?"

"Yes, come in," he said. "I had an interesting call from Hans yesterday."

Ana grimaced. "I'm sorry. He was talking about his competitors in Argentina, and I very casually mentioned some of our ideas for boosting demand. That was it, and we moved on. But I could tell he was filing it away. It was my mistake."

"We're at such an early stage with this, Ana, and it would be a major change for the company. The directors are big on keeping operations decentralized; they all emphasize the 'local approach' and how it has gotten us where we are today. They're still talking about Beatriz's fitness center! Getting everyone to buy into a corporate campaign, especially one targeting guests directly, would be an uphill battle, and we can't start it with rumors flying and our star managers assuming the worst. We have to develop a clear plan and get everyone on board—Hans, Beatriz, everyone."

"You're right, of course. How was Palma Cay?"

"The hotel looks great, but peak-season bookings are terrible. Beatriz wants more money for a promotion."

"Actually, I just got a similar request from Peter in Cancún."

"How much does he want?"

"$200,000."

Fernando sighed. "It's only a matter of time before others start to call. Well, we can probably increase bookings with local interventions like that, but what about something bigger and better coordinated? Why aren't we sharing data, establishing best practices, launching customer loyalty initiatives, getting our brand recognized? What about long-term strategy? This economy is a companywide problem, not a hotel-specific one."

As his voice rose, Ana moved to shut the door. "Believe me, I want all that, too," she said. "I've spent five years tinkering with brochures and uniforms. But I'm really not sure we can find a one-size-fits-all message that would work. I mean, we're in 21 countries. We have city, beach, golf, and mountain hotels. Spas, conference centers, pools, casinos. Families, couples, singles, businesspeople. Historical, modern. Old, young. How do you craft one message around all that? And how would a single price promotion work when the hotels are used to setting their own rates and discounts? Would it apply to everyone?"

"I agree that it would be difficult," Fernando said. "But it may be worth the risk. We could sort out the logistics on price; I think we would want to include every hotel and focus on early booking. And the message could be something around luxury, or personalization, or... " He trailed off, thinking about all the taglines he'd dreamed up over the past few months and then discarded as too narrow, or too bland, or too predictable.

"Why aren't we establishing best practices, launching customer loyalty initiatives, getting our brand recognized? What about long-term strategy?"

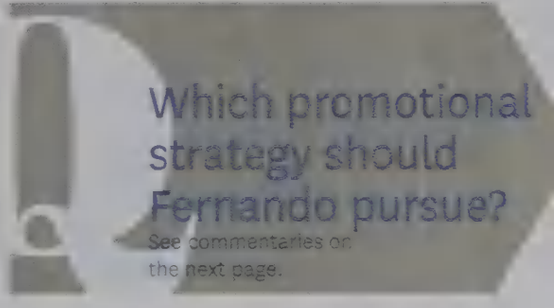
"Have you mentioned the idea to Carmen?"

"Not yet. But she's back from New York tomorrow. And she'll want to know how we're going to hit our numbers this year."

"At Palma Cay or companywide?"

"Both."

Marco Bertini is an assistant professor of marketing at London Business School. **John T. Gourville** is the Albert J. Weatherhead, Jr. Professor of Business Administration at Harvard Business School.



The Experts Respond



Raúl González is the CEO of Barceló Hotels & Resorts for Europe, the Middle East, and Africa.

IT'S UNDERSTANDABLE that Fernando desires a companywide campaign, but as he says, Alegre may not be ready. He should begin by allowing Beatriz to build a campaign for Palma Cay, which could then be used by other Alegre hotels in the same class. He could grant her request for funding on the condition that he work closely with her to develop a promotion and messaging that are relevant to other Alegre properties.

Of course, Fernando will face resistance from hotel managers who believe that Beatriz is getting special treatment in Alegre's otherwise decentralized structure. He needs to make it clear that this is not a precedent for bailing out hotels when their bookings are low. Rather, it is an investment in the brand: Palma Cay's campaign would benefit the entire portfolio. Similar appeals from other hotels should be considered case by case and approved only if they would provide broader benefits for the Alegre brand.

In building the campaign, Fernando and Beatriz need to address two underlying issues: how to alleviate the pressure on inventory management caused by last-minute reservations and how to break Alegre's dependence on intermediaries. These are common problems for hotel groups across Europe, including Barceló Hotels & Resorts.

To tackle the former, I would recommend that Alegre follow the airline industry model: Incentivize customers to book earlier by offering lower prices in return for advance purchase and prepayment, with fees for cancellations. We've tried this at several of our hotels with great success.

> Fernando needs to make it clear that Palma Cay's campaign would benefit the entire portfolio.

Dependence on intermediaries must be handled more delicately, because Alegre needs to maintain the strong relationships with tour operators, travel agencies, and online portals that have long generated the bulk of its bookings. But Fernando must figure out how to communicate directly with customers and take control of his brand. A campaign at Palma Cay would give him an opportunity to begin positioning Alegre with a target market while increasing bookings at its flagship.

This case study is based on Barceló's experience in Spain. In 2008, like many other hotel groups, we faced declining occupancy. Up until that time all marketing and promotional activities had been financed and managed at the hotel level. Managers in the region turned to headquarters for assistance in combating the crisis and increasing bookings. We used the opportunity to develop broader messaging that was relevant to all our hotels, but we focused on consumers in Spain.

Many people in the company feared that no one-size-fits-all campaign could possibly meet the needs and individual personality of every property, so we chose a tagline for a regional communications campaign that highlights the diversity of our offerings: "More than you can imagine." The tagline was used on the corporate website and in brochures, directories, and a promotional video.

Fernando could take this approach and use Palma Cay as a starting point to refine and even test Alegre's message before pushing a companywide campaign.



WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

STAYING CLOSE to each property's customers has obvious advantages. But a corporate brand is needed as well. Best Western's present tagline is "The World's Largest Hotel Family." It wants to be known not as a chain but as a collection of independent properties with similar values and standards. That model could be emulated.
Joseph E. Buhler, *senior analyst, PhoCusWright*

ALEGRE HAS a wide range of resorts and an equally diverse customer base, with different needs, tastes, and budgets. Find a promotional campaign that shows global presence but preserves the strategy of niche identity and pricing. Increase marketing by location. Work with travel agencies to push the unique experience. Don't treat the client like he's part of a herd.
Julio Garcia, *CEO, Victoria Travel*

AN OVERARCHING campaign wouldn't adequately stimulate demand across Alegre's range of customers, so Fernando should continue to let individual hotels drive promotional decisions. That said, a corporate branding strategy would allow the company to share insights across properties and develop targeted cross-selling messages, while guests accumulated points in a loyalty-rewards program.
Denise Lee Yohn, *branding consultant, Denise Lee Yohn, Inc.*

HBR's case studies appear at **hbr.org** prior to publication here.



Kevin Lane Keller is the E.B. Osborn Professor of Marketing at Dartmouth's Tuck School of Business.

FERNANDO SHOULD follow his instincts and creatively leverage the Alegre brand to benefit the entire portfolio. This collection of hotels needs to be greater than the sum of its parts. He should find ways to help consumers make appropriate connections between the hotels and increase the likelihood that they'll visit other Alegre properties.

However, it will be difficult to implement any companywide campaign if it's unclear what Alegre stands for as a brand. What is it that makes each property an Alegre hotel? Are all the hotels of the same quality? Do they offer the same experience? What is the thread that holds them together? Fernando's starting point should be an understanding of what it means from the customer's perspective to stay at an Alegre hotel.

That distinguishing quality then needs to be articulated to consumers, probably through a soft endorsement rather than a corporate brand. Because Alegre properties, unlike Hiltons and Marriotts, don't carry the company name, they have to establish the link for consumers. Each hotel could retain its unique identity but be labeled or endorsed as "an Alegre property," along the lines of what Starwood has done with its many brands and The Leading Hotels of the World has done more explicitly with its singular properties. To allay Hans's fears about diluting the brand, Fernando might consider developing two or three subbrand concepts to help logically categorize the hotels, such as "urban upscale" and "luxury family resort."

With a corporate endorsement, Alegre could more effectively cross-sell the hotels in its portfolio. For example, a loyalty program that gives customers the opportunity to earn travel rewards at any Alegre property might well increase reservations across the board.

Fernando should then devise a promotional campaign that individual hotels could adapt. It should not be heavy-handed. In fact, he should be careful to preserve the autonomy of the hotel managers while giving them the tools they need to effectively market their properties. If they were armed with a broader promotional message about the benefits of the Alegre brand, they could focus on explaining to consumers as well as travel agents and tour operators how their particular hotels deliver those benefits.

The sort of bottom-up branding approach that Beatriz advocates is rarely successful.

Saying no to Beatriz's request might be difficult for Fernando, especially if it meant accepting low bookings for the flagship in its first winter. But the sort of bottom-up branding approach that Beatriz advocates is rarely successful. Fernando could end up spending a lot of corporate money feeding individual budgets and miss the opportunity to build the reputation of Alegre's entire portfolio. He will get much greater bang for his buck if he smartly invests in the corporate brand.

HBR Reprint R1106M
Reprint Case only R1106X
Reprint Commentary only R1106Z

ALEGRE SHOULD build a brand around "wholesome vacations" to suit all needs—young or old, luxurious or budget-friendly, adventure or leisure—and create a loyalty program and a corporate web portal. This campaign would be centrally controlled, with every hotel manager contributing a pitch for his or her property; Fernando could develop a single image for the consumer to see.

Niket Anjaria, *management trainee, Raj Petro Specialities*

Harvard Business Review

Managing Collaboration

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Synthesis

A review of emerging ideas in the media



How Games Could Save the World

Can online collaborative play lead to real social change?

by Tim Sullivan

I have a confession: I am a games geek. I've lost untold hours of my life at various developmental stages wandering through forests in Dungeons & Dragons, conquering nations in Risk, and shooting imps in Doom. And don't get me started on the excitement of playing Pong on my cousin Scot's Atari 2600 in his parents' wood-paneled basement in the early 1980s. I will not admit to playing Angry Birds at work, but let's just say I know people who do.

I am not alone. Gaming in all its forms has a market cap estimated at more than $100 billion worldwide, with most of the recent growth coming from electronic games, both online and on consoles like Nintendo's Wii and their handheld siblings. One of the fastest-growing segments is social games—those notorious, terribly addictive time wasters on Facebook: FarmVille, Café World, Bejeweled Blitz, and the like. Their success has hinged on their capacity to blur the line between in-game credits and real money, and to unite your online gaming and your social network. They also appeal to audiences who traditionally have not played computer games. The typical social gamer looks like the typical gamer's mom: a 43-year-old woman.

Like any workers whose industry has been disrupted, game designers want to know what to do. At the most recent Game Developers Conference, in San Francisco, Raph Koster, Playdom's VP of creative design, identified the 40 core mechanics of effective social games. Koster's PowerPoint slides, all 190 of them, cover everything from the children's game Duck, Duck, Goose to Kriegspiel (19th-century German war-gaming) and Stanford psychologist Philip Zimbardo's experiments. (They're available on his website, at raphkoster.com.) Koster is a game designer who has been involved in some of the most successful online worlds, including Ultima Online, EverQuest, and Star Wars Galaxies. His slides demonstrate a keen understanding of what drives interaction and makes community work in the real world and how the core mechanics translate to online gaming.

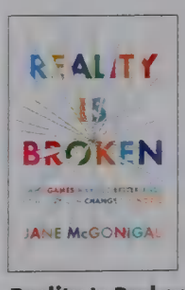
Social games, Koster notes, are excellent at harnessing gift giving (core

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mechanic #20). "This one," he writes, "social games nailed. Arguably, the biggest reason they are deserving of the name." He shows how gift giving and reciprocity (#21) act powerfully to build bonds, and how gaming could be far better at using the rituals (#19) that mark major life transitions. Social-game designers have tapped so successfully into these mechanics that some critics, mostly the designers of other games, call their creations "evil." Some of those same critics, who spend their professional lives designing very serious, complicated games for very serious, complicated gamers, can't quite get their minds around Café World's success.

Because developers now understand social mechanics so well, they can start applying them anywhere. And given the money at stake, they probably will. The Carnegie Mellon professor Jesse Schell has memorably called this the "gamification of everything." Some designers have already started businesses that aim to construct a "game layer" on top of the real world. The most successful of these, Foursquare, allows you to earn badges by "checking in" to real-world locations. Check in enough and you can become mayor of your favorite bar!



Reality Is Broken: Why Games Make Us Better and How They Can Change the World
Jane McGonigal
Penguin Press, 2011

Game Developers Conference
www.gdconf.com

Abdul Latif Jameel Poverty Action Lab
www.povertyactionlab.org

Innovations for Poverty Action
www.poverty-action.org

Yeah, I don't get it either.

Jane McGonigal, though, does. The author of the recently published *Reality Is Broken* and the director of game research and development at the Institute for the Future, McGonigal wants to use games as a tool to "make us better and...change the world." She gives us the prose-for-the-layperson version of Koster's slides, exploring how and why games make us happy and why so many people allow themselves to be pulled away from real life by the promise of online gaming. In short, she shows how some well-designed games more perfectly meet our social needs while being significantly less messy.

> "We are hardwired to care about reality—with every cell in our bodies and every neuron in our brains....That doesn't mean we can't play games."
> Jane McGonigal, *Reality Is Broken*

McGonigal's case for how games can fix the world has two prongs: First, games make us more collaborative and better at problem solving, and therefore better equipped, she argues, to deal with the massive and increasingly complicated problems the world faces. Second, social-game interfaces provide us with platforms that can actually help solve those problems. Some, like World Without Oil, already exist, and McGonigal sees a bright future for them (and, concomitantly, for us).

McGonigal's ideas are compelling and artfully presented, but her vision leaves me feeling pie-in-the-sky-ish and slightly suspicious. Games may well make us better at problem solving, tapping collective wisdom, and raising awareness, but changing the world is hard. Games have clear rules and rewards. In the real world, though, we never quite know what will work or why, and results can be counterintuitive at best, confoundingly impossible to untangle at worst. Games work only when the goal is clear, the reward structure is tiered, and we know what behavior we're being rewarded for. Conflicting desires and priorities, different (and equally valid) ideas of how to achieve goals, disagreement about what's valuable—these stand in the way of cheery gamification.

That's why the trial-and-error approach to seemingly intractable social and economic problems makes sense. Consider, for instance, one of our major attempts to change the world: the global effort to end poverty, ongoing since the end of World War II—just the kind of problem McGonigal would like to tackle. We've learned that sometimes even well-designed targeted interventions fail, and even small, incremental changes are difficult to make stick.

Researchers at MIT's Poverty Action Lab and at Innovations for Poverty Action, a research lab based in New Haven, Connecticut, now look to the power of randomized trials, the same methodology that scientists use to test their hypotheses. They are guardedly optimistic that with enough work, they'll find some interventions that can make small corners of the world slightly better.

Hearing that message—targeted interventions, incremental progress, learning through failure—is a lot like hearing your doctor say "Eat less and exercise to lose weight" after you've read about a terrific new diet pill in the waiting room. The message is also more realistic, and deserves our attention and effort. But I bet that when we need a break from all that hard work, we'll have some terrific games to take our minds off our troubles.

Tim Sullivan is a senior editor at *Harvard Business Review*.

Executive Summaries June 2011

SPOTLIGHT ON PRODUCT INNOVATION



This collection of articles includes two company stories, from Procter & Gamble and Intuit; a piece on how leaders should manage tensions between core businesses and new-growth initiatives; and a look at the surprising number of products you could probably launch without doing any R&D.

SYSTEMATIZING INNOVATION

How P&G Tripled Its Innovation Success Rate

Bruce Brown and Scott D. Anthony | page 64

Could P&G marry Edison's creativity with the speed and reliability of Ford's factory?

In the early 2000s, faced with an alarming gap between its growth goals and what its innovation pipeline was delivering, Procter & Gamble created a "new-growth factory"—a network of novel structures and capabilities to rapidly shepherd new products and even business models from inception to market. The resulting innovations range from a 33-cent razor for customers in emerging economies to Tide Dry Cleaners—establishments with drive-through windows and 24-hour drop-off and pickup.

Brown, who is P&G's chief technology officer, and Anthony describe the factory's components and practices: new-business-creation groups, entrepreneurial "guides" to help them, an innovation manual, a disruptive-innovation "college," and more. They also offer six lessons for leaders seeking to set up new-growth factories of their own.

Although the factory is still ramping up, its early successes suggest that collective creativity *can* be managed—and can generate sustainable sources of revenue growth no matter how big a company becomes.

HBR Reprint R1106C

LEADERSHIP

The Ambidextrous CEO

Michael L. Tushman, Wendy K. Smith, and Andy Binns | page 74

Although most managers publicly acknowledge the need to explore new businesses and markets, the claims of established businesses on company resources almost always come first, especially when times are hard.

When top teams allow the tension between core and speculative units to play out at lower levels of management, innovation loses out. At best, leaders of core business units dismiss innovation initiatives as irrelevancies. At worst, they see the new businesses as threats to the firm's core identity and values.

Many CEOs take a backseat in debates over resources, ceding much of their power to middle managers, and the company ends up as a collection of feudal baronies. This is a recipe for long-term failure, say the authors. Their research of 12 top management teams at major companies suggests that firms thrive only when senior teams lead ambidextrously—when they foster a state of constant creative conflict between the old and the new.

Successful CEOs first develop a broad, forward-looking strategic aspiration that sets ambitious targets both for innovation and core business growth. They then hold the tension between innovation unit demands and core business demands at the very top of the organization. And finally they embrace inconsistency, allowing themselves the latitude to pursue multiple and often conflicting agendas.

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INNOVATION & CREATIVITY

The Innovation Catalysts

Roger L. Martin | page 82

A few years ago the software development company Intuit realized that it needed a new approach to galvanizing customers. The company's Net Promoter Score was faltering, and customer recommendations of new products were especially disappointing. Intuit decided to hold a two-day, off-site meeting for the company's top 300 managers with a focus on the role of design in innovation. One of the days was dedicated to a program called Design for Delight.

The centerpiece of the day was a PowerPoint presentation by Intuit founder Scott Cook, who realized midway through that he was no Steve Jobs: The managers listened dutifully, but there was little energy in the room. By contrast, a subsequent exercise in which the participants worked through a design challenge by creating prototypes, getting feedback, iterating, and refining, had them mesmerized.

The eventual result was the creation of a team of nine design-thinking coaches—"innovation catalysts"—from across Intuit who were made available to help any work group create prototypes, run experiments, and learn from customers. The process includes a "painstorm" (to determine the customer's greatest pain point), a "soljam" (to generate and then winnow possible solutions), and a "codejam" (to write code "good enough" to take to customers within two weeks). Design for Delight has enabled employees throughout Intuit to move from satisfying customers to delighting them.

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FRUGAL PRODUCT DEVELOPMENT

Innovating on the Cheap

Lance A. Bettencourt and Scott L. Bettencourt | page 88

No investment in innovation is ever a sure bet. Typically, innovation success rates are low, and returns are slow to materialize—if they're generated at all. This makes innovation initiatives hard to justify when money is tight. But even then, it's still possible to launch new offerings that excite customers. The trick is to find the promising assets you already have in hand.

According to strategy consultant Lance Bettencourt and consumer-products executive Scott Bettencourt, almost every company has previous discoveries with overlooked market potential. The six most common types of in-hand innovations include products that failed to launch because of particular circumstances, which may have changed since then; previously developed capabilities and features addressing customer needs that have recently risen in prominence; products that customers like for unexpected reasons and that could take off if repositioned; extras created for bundled offerings that could be spun out as stand-alone products; separate components that could be combined into an enhanced offering; and overdesigned products that could be simplified to help the company reach new customer segments.

With such innovations, much of the work has already been done. They can be brought to market with relatively minimal effort, resources, and risk and swiftly boost a company's bottom line.

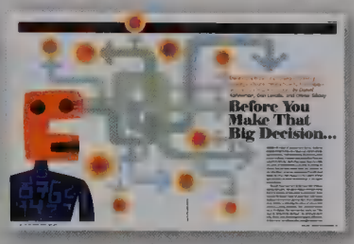
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The Big Idea

DECISION MAKING

Before You Make That Big Decision...

Daniel Kahneman, Dan Lovallo, and Olivier Sibony | page 50



When an executive makes a big bet, he or she typically relies on the judgment of a team that has put together a proposal for a strategic course of action. After all, the team will have delved into the pros and cons much more deeply than the executive has time to do. The problem is, biases invariably creep into any team's reasoning—and often dangerously distort its thinking. A team that has fallen in love with its recommendation, for instance, may subconsciously dismiss evidence that contradicts its theories, give far too much weight to one piece of data, or make faulty comparisons to another business case.

That's why, with important decisions, executives need to conduct a careful review not only of the *content* of recommendations but of the recommendation *process*. To that end, the authors—Kahneman, who won a Nobel Prize in economics for his work on cognitive biases; Lovallo of the University of Sydney; and Sibony of McKinsey—have put together a 12-question checklist intended to unearth and neutralize defects in teams' thinking. These questions help leaders examine whether a team has explored alternatives appropriately, gathered all the right information, and used well-grounded numbers to support its case. They also highlight considerations such as whether the team might be unduly influenced by self-interest, overconfidence, or attachment to past decisions.

By using this practical tool, executives will build decision processes over time that reduce the effects of biases and upgrade the quality of decisions their organizations make. The payoffs can be significant: A recent McKinsey study of more than 1,000 business investments, for instance, showed that when companies worked to reduce the effects of bias, they raised their returns on investment by seven percentage points.

Executives need to realize that the judgment of even highly experienced, superbly competent managers can be fallible. A disciplined decision-making process, not individual genius, is the key to good strategy.

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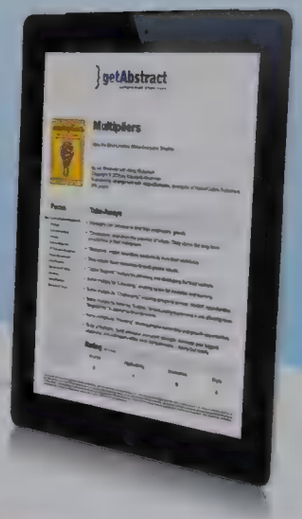
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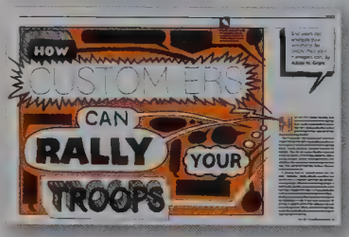
How I Did It

THE GLOBE

HUMAN RESOURCES

How Customers Can Rally Your Troops

Adam M. Grant | page 96



Customers, clients, and patients help bring a leader's vision to life.

A growing body of research shows that end users—customers, clients, patients, and others who benefit from a company's offerings—can be important allies for leaders. By serving as tangible proof of the consequences and purpose of employees' efforts, end users motivate people to work harder, smarter, and more effectively.

In his research, the author invited a scholarship recipient to spend five minutes visiting with university fundraising callers, who generally had no contact with the beneficiaries of their efforts. One month later, callers showed, on average, 142% increases in weekly time spent on the phone and 171% increases in money raised.

Leaders are not lone heroes who must rally their employees to do great things. They need partners who can enhance the meaning employees derive from their jobs. End users can inspire workers by demonstrating the impact of their efforts, showing appreciation for their work, and eliciting employees' empathy for them.

To outsource inspiration effectively, leaders must identify end users (both past and present), collect their stories, introduce them to employees across the organization, and recognize workers' impact on customers' lives.

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STRATEGY & COMPETITION

Competing Against Free

David J. Bryce, Jeffrey H. Dyer, and Nile W. Hatch | page 104



The "free" business models popularized in the digital world by companies such as Google, Adobe, and Mozilla are spreading to markets in the physical world. How should established companies respond? The authors have found that some are too quick to offer free products of their own. Many more either don't move quickly enough or simply fail to respond at all, even when they have the resources to win a head-to-head battle. Consider the reluctance of almost all U.S. newspapers to counter the attack on their classified advertising business from Craigslist.

To determine the level of threat posed by a free-product rival, a company should assess the rate at which its own paying customers are defecting versus how quickly the entrant's user base is growing. Most incumbents can fend off the assault by introducing a better free offering and generating revenues and profits through up-selling, cross-selling, selling access to their customers, and bundling the free product with paid offerings.

Embracing free strategies is not easy for managers at established companies. One obstacle is the profit-center structure, which makes it impossible to consider a product's revenues and costs separately. Another is the cost accounting system, which is not good for identifying the actual expense of generating additional offerings. To overcome these challenges, managers can push profit responsibility up, push revenue and cost responsibilities down to separate groups, and step back from the cost accounting system. They may find pricing flexibility they didn't realize they had.

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STRATEGY & COMPETITION

Segmenting the Base of the Pyramid

V. Kasturi Rangan, Michael Chu, and Djordjija Petkoski | page 113



The bottom of the economic pyramid is a risky place for business, but decent profits can be made there if companies link their financial success with their constituencies' well-being. To do that effectively, you must understand the nuances of people's daily lives, say Rangan and Chu, of Harvard Business School, and Petkoski, of the World Bank.

Start by dividing the base of the pyramid into three segments according to people's earnings and related personal needs:

- Low income: 1.4 billion people, $3 to $5 a day
- Subsistence: 1.6 billion people, $1 to $3 a day
- Extreme poverty: 1 billion people, less than $1 a day

Next, consider the roles of various groups in the value-creation relationship: consumers, coproducers, and clients. Specific strategies work best with people in certain roles and at particular income levels.

Success requires appreciating the diversity at the base of the pyramid and the importance of scale in undertaking ventures there. Witness Manila Water's success in the Philippines and Hindustan Unilever's in South Asia. Failure to appreciate those elements can foil base-of-the-pyramid ventures, as Microsoft and Procter & Gamble each discovered.

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ENTREPRENEURSHIP

Genpact's CEO on Building an Industry in India from Scratch

Pramod Bhasin | page 45



Bhasin was the head of GE Capital in India when, in the late 1990s, he had a vision for the future of a small division that was providing back-office services such as processing car loans and credit card transactions for the local market. GE Capital was the first foreign-owned financial services company that had been allowed into India. Considered an experiment by the government, it was hypervulnerable to changes in policy and philosophy. Bhasin wanted to find a safe and sustainable means of growth. The eager, ambitious talent pool he could see all around him, both inside the company and across the country, gave him an idea: Why not take advantage of that resource to offer support services to GE Capital all over the world?

The people he turned to for advice were uniformly discouraging. How, they asked, could he build a facility on the scale he would need, hire huge numbers of people and train them to Six Sigma standards on products they knew nothing about, and gain access to telecommunications and infrastructure at a level then unheard of in India? Undaunted, Bhasin pressed on, and today Genpact, which was spun off from GE Capital in 2005, directly employs 43,000 people and serves 400 other companies in 13 countries.

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Managing Yourself

LEADERSHIP

The Paradox of Excellence

Thomas J. DeLong and Sara DeLong | page 119



Why is it that so many smart, ambitious professionals are less productive and satisfied than they could be? Thomas DeLong, an academic and consultant to executives, and Sara DeLong, a psychiatrist, argue that it's often because they're afraid to demonstrate any sign of weakness. They're reluctant to ask important questions or try new approaches that push them outside their comfort zones.

For high achievers, looking stupid or incompetent is anathema. So they stick to the tasks they're good at, even while the rest of the organization may be passing them by. In short, they'd rather do the wrong thing well than do the right thing poorly. They get stuck in this unproductive and unfulfilling pattern and can't break free.

Of course, leaders in organizations bear some of the blame for this type of play-it-safe mind-set. They don't always want to hear that a person is struggling, nor do they necessarily reward risk taking, even though they might pay lip service to innovative initiative.

The authors outline several steps that individuals can take to shake off fear and paralysis, including looking at past negative experiences from somebody else's point of view and seeking out safe ways to allow themselves to become vulnerable.

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Ferran Adrià

has spent three decades reinventing high cuisine—working at his restaurant, elBulli, in Roses, Spain, and his Barcelona food "laboratory," from which creations such as sea urchin foam and curry ice cream have emerged. With a staff of 67 that serves dinner to only 50 patrons a night, only six months of the year (though it gets some 2 million reservation requests annually), elBulli is regularly ranked the world's best restaurant. But this summer will be its last. Starting in 2014, Adrià will instead run a foundation to advance the art and science of cooking. *Interviewed by Alison Beard and Sara Silver*

HBR: Explain how your creative team works.

Adrià: We are six people—a creative collective—and each person has his own method. But it's mainly trial and error. If you have an idea, you keep trying it until it works. We don't create dishes. They arise from the creation of new techniques and concepts. It's like a building: We begin with one element or material. Then we work to perfect it, starting with small quantities, going bit by bit. If we make a mistake, we change it the next day. It's a success if it opens a new path and excites you.

Where do you get your inspiration?

One shouldn't speak only to other chefs; inbreeding is no good. You get ideas from life, from reading, from travel. For example, the sensibility, the philosophy, the fragility of Japan had a big impact on my career. It's also important to be connected to other disciplines: art, science, history. When an architect designs a building, he has to work with engineers and people in new technologies. It's the same in cooking. We turn to science, for example, to explain the "why" of things.

How do you lead your restaurant?

It's like any work. You need concentration and professionalism. And it's very important to have passionate people with their own imagination. I'm the boss, and I pick the best team. We have 40 people in the kitchen and five managers. Everyone participates. And you create an environment that gives them space and the sense that they're taking part in something very important. You can only improve the ones who are already good; you can't do anything with the bad ones. Talent and capability lie with the person, not with the teacher.

How do you make a good chef better?

It's the whole system of elBulli that does it. If you're at Harvard, it's not a single person that makes you better, it's the system. The way we function is based on a model which holds that when you're here, you get to dream and be passionate. But it's 12 to 13 hours a day—very intensive. Ninety percent of the staff changes each year. I think it works, because new blood is good and in the end everyone burns out. For them it's a year of experience. They take it on and see what they can learn.

What can elBulli teach other businesses?

Restaurants have something really good, which is immediacy. If you drink a coffee, you want it fast and hot; you don't want to wait. So we have a system of work that this immediacy requires, and it can be transferred to the largest companies.

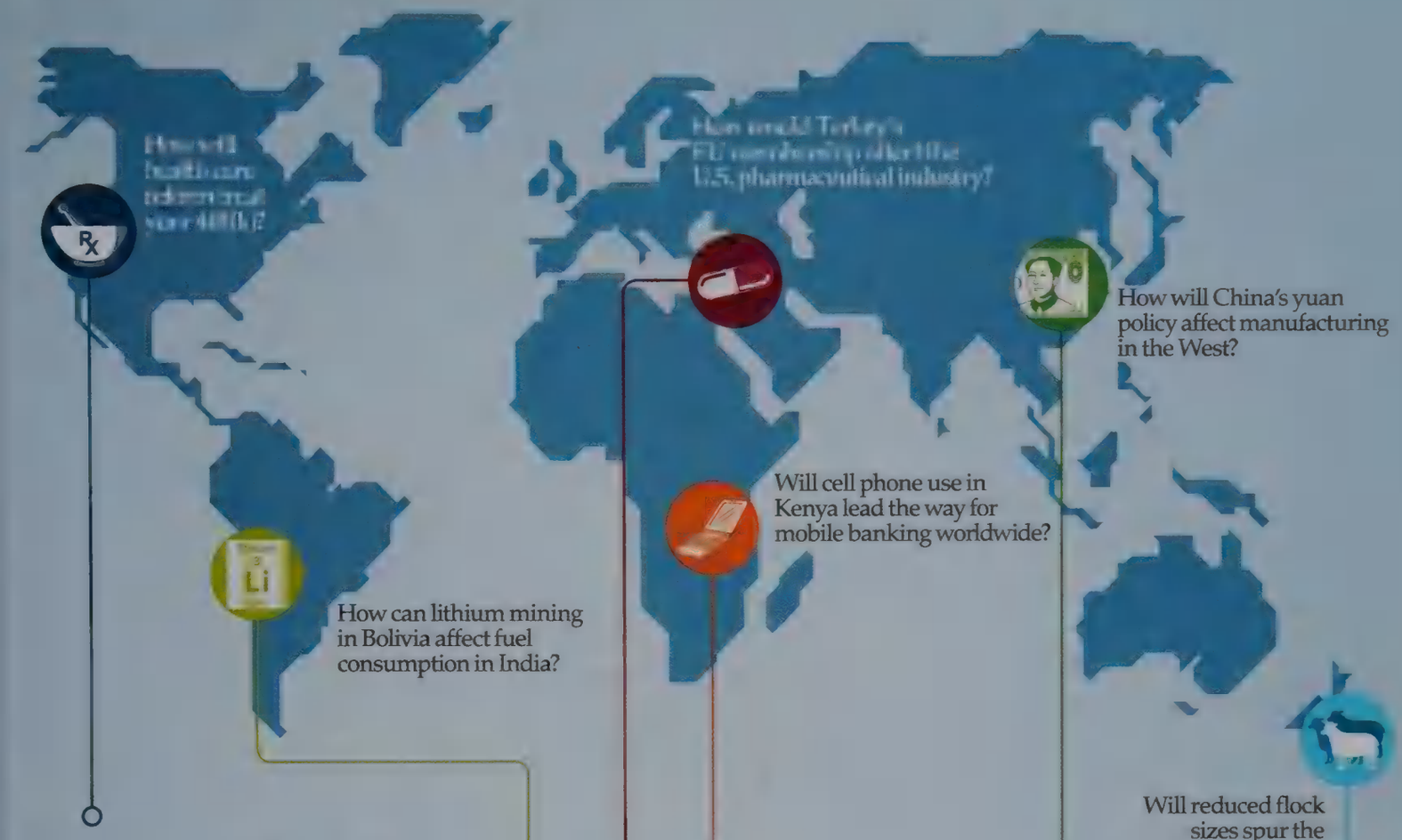
You've worked as a consultant to many industries. Is there a common problem you see?

The people in charge are always too far away from research and development. Decision makers should have a direct link to the people behind new ideas and products.

Why are you closing elBulli?

The pressure to serve doesn't offer the kind of tranquillity necessary to create as we would like. It's important to "oxygenate"—to adapt our vital rhythms to a new set of demands.

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